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SUPERIOR COURT OF THE STATE OF CALIFORNIA

COUNTY OF SAN DIEGO

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM, by and through its Board of Administration,

Plaintiff,

v.

SAN DIEGO CITY ATTORNEY MICHAEL J. AGUIRRE, THE CITY OF SAN DIEGO and DOES 1-100,

Defendants.

CITY OF SAN DIEGO,

Cross-Complainant,

v.

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM, by and through its Board of Administration; RON SAATHOFF; JOHN TORRES; MARY VATTIMO; CATHY LEXIN; TERRI WEBSTER; SHARON WILKINSON; JOHN TORELL in his capacity as City Auditor and Comptroller, AND ROES 1-50, inclusive,

Cross-Defendants.

CASE NO. GIC841845
[Consolidated with Cases No. GIC851286 and GIC852100]

DEFENDANT AND CROSS-COMPLAINANT CITY OF SAN DIEGO'S PROPOSED STATEMENT OF DECISION ON TRIAL PHASE I

Date: To Be Announced
Time: 9:00 a.m.
Judge: Hon. Jeffrey B. Barton
Dept.: 69

Trial Date: October 6, 2006
Action Filed: January 27, 2005

Unlimited Civil Case

Pursuant to this Court's Order regarding the Phase I trial proceedings, the City of San Diego hereby lodges its Proposed Statement of Decision on Phase I issues, which is attached hereto. As the Court requested, a CD-Rom containing the Statement of Decision in Word format is also lodged herewith.

DATED: November 28, 2006

Respectfully submitted,

Michael J. Aguirre
SAN DIEGO CITY ATTORNEY

SUPERIOR COURT OF THE STATE OF CALIFORNIA

COUNTY OF SAN DIEGO

SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM, by and through its Board of Administration,

Plaintiff,

v.

SAN DIEGO CITY ATTORNEY MICHAEL J. AGUIRRE, THE CITY OF SAN DIEGO and DOES 1-100,

Defendants.

CITY OF SAN DIEGO,

Cross-Complainant,

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SAN DIEGO CITY EMPLOYEES' RETIREMENT SYSTEM, by and through its Board of Administration; RON SAATHOFF; JOHN TORRES; MARY VATTIMO; CATHY LEXIN; TERRI WEBSTER; SHARON WILKINSON; JOHN TORELL in his capacity as City Auditor and Comptroller, AND DOES 1-50, inclusive,

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[PROPOSED] STATEMENT OF DECISION ON TRIAL PHASE I

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I.

INTRODUCTION

The City of San Diego ("City") is proceeding by way of its Fifth Amended Cross-complaint ("5ACC") to set aside alleged illegal benefits that have caused the City employees' pension plan to be "at risk." The Court ordered trial on five Phase One issues as follows: (1) Whether the 5ACC presents an actual, justiciable controversy between the City and the necessary parties; (2) whether the 5ACC presents an actual, justiciable controversy on which this Court can render a meaningful, concrete and specific decree; (3) whether the City's claims that the pension benefits are null and void are barred because of the *Gleason* settlement; (4) whether the City can pursue a claim that the San Diego City Employees' Retirement System violated the Debt Limit Laws; and (5) whether the *Corbett* settlement provides a bar to the litigation of certain of the benefits.

After extensive pretrial and trial proceedings, for the reasons set forth below, the Court holds that all necessary parties are before the Court; the Court has the authority to fashion a remedy; the *Corbett* and *Gleason* settlements do not preclude adjudication of the legality of pension benefits; and the City may proceed to trial on its claim under the Debt Limit Laws. The case is justiciable and should be tried on its merits.

II.

FACTUAL BACKGROUND

The City asserts certain government officials violated prohibited financial interest and debt limit laws when they developed and approved City employee pension benefit increases while (1) those officials stood to personally benefit from the increases, (2) the benefit increases were contingent upon allowing underfunding of the pension system the officials were duty-bound to protect, and (3) the debt created exceeded same-year revenues.[1]

---

[1] The prohibited financial interest law relied upon by the City is set forth in California Government Code Sections 1090 and 1092 and San Diego City Charter Section 94. The debt limit law relied upon by the City is contained in the California Constitution, Article XVI, Section 18 and San Diego City Charter Section 99.

These unlawful actions allegedly were taken by members of the Board of Administration ("Board") of the San Diego City Employees' Retirement System ("SDCERS") and certain City officials who participated in the development and approval of two agreements and related changes in the San Diego Municipal Code, known as Manager's Proposals I and II ("MP I" and "MP II"). While the facts will not be determined until the conclusion of the remaining trial proceedings, the events are memorialized in the official record of the public proceedings underlying this litigation, of which the Court previously took judicial notice. Because this record and the trial evidence inform the decisions as to what remedy might be appropriate and, in turn, which parties are necessary, it is reviewed in some detail.

A. Manager's Proposal I

Former San Diego City Manager Jack McGrory and former SDCERS President Keith Enerson discussed the outline of the plan behind MP I at a February 26, 1996 meeting. Lawrence Grissom, the former SDCERS Administrator, who also participated in the February 26, 1996 meeting, described the "package" in a March 1, 1996 draft memorandum:

> What follows is a proposal for implementing the ***package*** that you Jack and I discussed on February 26. It is necessarily a little rough due to time constraints. I will start with reserve crediting of undistributed income since the rest of the package flows out of this.

Ex. 50 (emphasis added).

The March 1, 1996 "package" memorandum further discusses a plan to provide the City with "rate stabilization," by using SDCERS funds to "cover shortfalls in contributions" from the City to SDCERS. Ex. 50.2. Under a heading entitled "Analysis" is a summary of the objectives of MP I, which included not only a provision to allow the City to pay less to the pension system, but also possibly to fund more pension benefits:

> These actions set up the structure necessary to provide for rate stabilization, providing a reserve to protect the 13th check, payment of insurance premium costs, capturing some of the tremendous earnings we are currently experiencing, and, as will be discussed later, possibly funding some additional benefits.

Ex. 50.2.

///

The memorandum discussed "three drawbacks to this approach":

> 1. Perception. It looks like the Board is "giving" the City a lot of money. This is, frankly a political and negotiation issue. The negative perception should be at least partially offset by increasing benefits as discussed below.
>
> 2. Outside counsel. I have no idea whatsoever how outside counsel will react to this plan. We should consider this carefully and thoroughly strategize our approach.
>
> 3. Holding Stabilization Reserve outside valuation assets. The net effect is to increase the System's unfunded liability.

Ex. 50.3

Under the outlined plan, the City's contribution to the pension system between Fiscal Years 1996 to 2000 would be at set percentages of payroll, rather than determined by the SDCERS actuary. The City's proposed rates were set out in a table in the March 1 package memorandum as follows:

	PUC RATE FY 96 EAN Rate FY97+	RATE TO PAY	% DIFF	$$ DIFF
FY96	8.6%	7.08%	1.52%	$5.65
FY97	10.20%	7.33%	2.87%	$11.16
FY98	10.20%	7.58%	2.62%	$10.64
FY99	10.20%	8.20%	2.00%	$8.42
FY2000	10.20%	8.20%	2.00%	$8.86

Ex. 50.4. The memorandum also discussed benefit improvements proposed as part of the plan. Ex. 50.6-7.

A written version of MP I was presented by Jack McGrory at a Special Meeting of the SDCERS Board held on May 2, 1996. At that meeting, the then-City Manager,

> Mr. McGrory stated that the City has been working to resolve various problems facing the Retirement System and related benefit problems. He added that today's presentation is the conceptual framework to address some of these issues . . . .

Ex. 276.1.

> Mr. McGrory stated that it has become difficult for the City to work with the System's fluctuating rates. In exchange for benefits improvements contained in the proposed package, he stated that the City needs help with the Earnings Stabilization Reserve.

Ex. 276.2.

Attached to the SDCERS Board Meeting Minutes for that date is the Manager's Proposal dated May 2, 1996. In the "Concept Overview," the Manager (McGrory) addressed benefits and funding issues:

> It is the City Manager's intent to recommend changes to the City Employees Retirement System related to: (1) retiree health insurance, (2) retirement plan benefits, (3) employer contribution rates and calculation method, and (4) retirement system reserves. These proposed changes to plan benefits, retiree health insurance, employer rate calculations and system reserves will require approval of the City Council [and] CERS Board of Administration . . . . The interrelationship of these various issues to each other necessitate that the entire proposal be considered and acted upon concurrently. Furthermore, the substantial financial implications to the City compel that certain actions occur in time for Fiscal Year 1997 budget decisions.

Ex. 276.6. The proposal then describes the benefit increases, including the increase in the General Member benefit formula. *Id.* at 276.8. Attached to the proposal are summary tables, which show both the City contribution rate relief and the benefit increases. *Id.* at 276.11-276.16. That outline also reflects the need for SDCERS Board approval. *Id.* at 276.26.

Unions representing the City workers were also included in the discussions about the proposed rate stabilization plan. On May 17, 1996, the San Diego Municipal Employees' Association ("MEA") lawyer Ann Smith sent a letter proposing that the General Member formula be increased from the 1.75% at age 55 (proposed by Manager McGrory in his May 2, 1996 presentation) to 2.24% at age 55. Ex. 87.3. In her May 17 letter, entitled "MEA's PROPOSAL FOR RESOLUTION OF RETIREMENT SYSTEM ISSUES AND CONTRACT EXTENSION COVERING FY98," Ms. Smith referred to the "on-going discussions regarding retirement system issues and the invitation to discuss an extension of the current MOU for FY 98." Ms. Smith continued: "I cannot state strongly enough how committed MEA's leadership and Negotiating Team" are to "a vast improvement in the retirement formula for general

members . . . ." *Id.* In reference to Manager McGrory's plan to lower the City's annual pension contributions, Ms. Smith wrote:

> I also cannot over-emphasize that the level of employee scepticism [sic] and distrust regarding any tampering with funding methods related to the retirement system is enormous and will require a yeoman's effort by every person associated with MEA to overcome. MEA will not undertake this formidable task unless the gains in benefit levels for the employees MEA represents are clearly respectable and credible rather than de minimus. Frankly, at this juncture, the proposal to increase the general member's formula from 1.48% to 1.75% at age 55 is de minimus when contrasted with a proposed safety formula of 3% at age 55 and 2.74% at age 50.

Ex. 87.1.

Manager McGrory subsequently revised his proposal to increase the general member formula to 2.0% at 55. He also changed the proposal to extend the rate stabilization period to 2008. The City Manager circulated the revised proposal on June 7, 1996. Ex. 276.93. Again, that proposal stated that the benefits and funding terms were part of the plan: "It is the City Manager's intent to recommend changes to the City Employees' Retirement System related to: (1) retiree health insurance, (2) ***retirement plan benefits***, (3) ***employer contribution rates***, and (4) retirement system reserves." Ex. 276.93 (emphasis added). This would require the approval of "the City Council [and] CERS Board of Administration . . . ." *Id.* The Proposal states:

> ***The interrelationship of these various issues to each other necessitate that the entire proposal be considered and acted upon concurrently***. Furthermore, the substantial financial implications to the City compel that certain actions occur in time for Fiscal Year 1997 budget decision.

Id. (emphasis added).

The Proposal then describes the multiple benefit increases that will be afforded to the employees, including an increase in the General Member benefit formula. *Id.* at 276.94. This benefit increase imposed substantial past liability, which would be paid for out of the funds already in the system. *Id.* at 276.95. As part of this agreement, along with the increase of benefits (granted without new funding), the City's Employer Contribution Rates were reduced markedly. *See id.* at 276.97. In some years, the City's contribution would decrease 3% to 4%,

for a total decrease in funding obligation over the life of the agreement of $110.35 million. *Id.* Rather than the actuarially-calculated rate, the City would pay the "agreed rate" from FY1996 to FY2007, and the difference between the two would be funded out of the Stabilization Reserve, *i.e.,* out of monies already in the system. If the amount in that reserve became insufficient, or the funded ratio fell more than 10% below the funded ratio calculated at the June 30, 1996 valuation (the 82.3% "trigger"), the plan would sunset the following year. *Id.* at 276.98.

On June 11, 1996, the SDCERS Board held a "Special Workshop" relating to the Manager's Proposal. The Workshop minutes confirm that the "plan" was the subject of discussions between the City Manager's office and the unions, as well as the SDCERS Board:

> [Mr. McGrory] indicated that the Manager's office had been discussing all of the aspects of their proposal with the employee groups and seeking their concurrence with the plan.

Ex. 276.67. Mr. McGrory made clear that the plan included a substantial increase in a variety of benefits, and "assist[ance to] the City in stabilizing their contribution rates." *Id.* at 276.68. The City's contribution would be "stabilized" by using the system's reserve funding to offset the cost of benefit increases, and to fund a portion of the City's necessary contribution rates. *Id.* at 276.69-276.70. The concept, stated simply, was to use the system's reserves, which had grown due to investment successes in recent years, and thereby fund both benefit increases and City contributions. *Id.* at 276.73. *See also id.* at 276.77.

Under the new version of MP I, the rate stabilization period was extended from Fiscal Year 2000 to Fiscal Year 2008:

Employer Contribution Rate Stabilization Plan

Period	PUC Rate	City Paid Rate	Difference %	Difference $
FY96	8.60%	7.08%	1.52%	$5.33m
FY97	10.87%	7.33%	3.79%	$13.88m
FY98	12.18%	7.83%	4.35%	$16.67m
FY99	12.18%	8.33%	3.85%	$15.40m
FY2000	12.18%	8.83%	3.35%	$14.00m
FY2001	12.18%	9.33%	2.85%	$12.45m
FY2002	12.18%	9.83%	2.35%	$10.72m

Period	PUC Rate	City Paid Rate	Difference %	Difference $
FY2003	12.18%	10.33%	1.85%	$8.82m
FY2004	12.18%	10.83%	1.35%	$6.73m
FY2005	12.18%	11.33%	.85%	$4.43m
FY2006	12.18%	11.83%	.35%	$1.91m
FY2007	12.18%	12.18%	-0-	-0-
FY2008	13.00	13.00%	-0-	-0-
TOTAL				$110.35*

*$110.35 million paid from excess earnings includes $17.31 million in contributions as a result of benefits improvements recommended herein.

Ex. 155.10

The discussion, as recorded in the SDCERS Meeting Minutes, reflects that this was a "package":

> Mr. Barnett asked if this is being presented as a complete "take-it" or "leave-it" package.
>
> Mr. McGrory responded that . . . this is a comprehensive approach.

Ex. 276.75.

Mr. McGrory observed in closing,

> [t]hat he believes that these two bodies [the Manager's Office and the Board], ***along with the employee organizations***, have developed an acceptable plan that will solve the City's short and long term problems with the System . . . .

Id. at 276.78 (emphasis added).

The system's actuary also presented his conclusions at this Board meeting. He said that "from a technical standpoint," to fund the new benefits that are part of this proposal, "there would be approximately [an] $80 million [liability] which will have the [i]mpact of a 5% reduction in whatever the funding ratio would be at that point." *Id.* at 276.78-276.79. *See also id.* at 276.81 ("the funded ratio would drop by 5%").

Several Board members recognized the impact of the benefit increases on future generations of taxpayers. First,

> Ms. Jamison stated that the City's contribution rates would be increasing over time and that the curve, relative to what it would have been, is going to decrease at some point. She questioned whether future tax payers would be placed in a position of having to pay for these benefit increases if they are adopted . . . .

Id. at 276.81. Another Board member took up the same issue:

> Mr. Casey stated that there is an underlying statement in the Charter that indicates that today's service credit must be paid for by today's taxpayers. He stated that this proposal gives him the distinct impression that future taxpayers will be paying for these benefit increases . . . .

Id. at 276.82. Mr. Casey further stated:

> [I]f this proposal is implemented, he has concerns that the younger generation will be expected to pay retirement benefits for today's generation. He stated that he does not believe this is appropriate.

Id. The system's actuary agreed:

> Mr. Roeder responded that there is no question that the rate that is being agreed upon is less than what he considers to be the "ivory tower" actuarial rate over the next ten years. Therefore, some of these costs will be borne by the future generation.

Id.

Fiduciary counsel to the Board, Mr. Hamilton, thought the agreement raised "red flags" regarding the Board's duty to the pension system itself:

> He stated that there were "red flags" raised in his mind by this proposal as it relates to the Board's duty of loyalty to the integrity of the fund . . . .

Ex. 276.84. Further,

> he reminded the Board that the pension beneficiaries and members have a vested right to an actuarially sound system and that the Board has a duty of loyalty to the integrity of the fund that can not be contracted away.

Id. at 276.86.

Another Board member, Ms. Parode, echoed this point, stating that "current employees would be excited about receiving improved benefits," and therefore it was the fiduciaries' duty to be "concerned about the long-term funding of the System." *Id.* at 276.88. "[S]he questioned how far unfunded a system can become before becoming susceptible to a challenge on the

Board's management of the fund." *Id.* Mr. Hamilton responded that "the liability of current employees/retirees are [sic] being transferred to future taxpayers." *Id.*

Another Board member, Ms. Wilkinson, stated that "[g]iven the 'red flags' raised today, she questioned whether Mr. Hamilton would recommend that the Board vote on this issue at their 6/21/96 meeting." *Id.* at 276.89. Mr. Hamilton responded:

> [T]his would depend on how quickly these issues can be resolved. If all of the parties can come to an agreement, he stated that he does not foresee a problem.

Id. at 276.90. The Chair, Mr. Enerson, concluded by stating that "he would like to plan for success." *Id.* at 276.90.

The revised June 7 Proposal was amplified in a memorandum to the SDCERS Board from Manager McGrory dated June 21, 1996—the day the SDCERS Board considered the proposal. The memorandum made specified changes to the June 7 Proposal. Ex. 43. McGrory again made clear that there was one deal: "These benefit changes . . . are presented as part of the overall proposal." Ex. 43.2. The memo modified the sunset provision to make clear that the new benefits are an integral part of the funding calculation—indeed, the benefits are accounted for in the actuarial valuation sunset provision adopted by the Board:

> The City will pay the agreed to rates shown above for FY96 through FY 2007. In the event that the funded ratio of the System falls to a level 10% below the funded ratio calculated at the June 30, 1996 actuarial valuation which will include the impact of the benefit improvements included in this Proposal, the City-paid rate will be increased on July 1 of the year following the date of the actuarial valuation in which the shortfall in funded ratio is calculated. The increase in the City-paid rate will be the amount determined by the actuary necessary to restore a funded ratio no more than the level that is 10% below the funded ratio calculated at the June 30, 1996 actuarial valuation.

Id. at 43.2.

The memorandum then spells out the financial impact of the agreement. "When benefits are increased, liability is created representing the prospective value of those benefits. Employee and employer contribution rates are increased for the purpose of paying that cost as it is accrued." *Id.* at 43.3. As for Past Service Liability:

/ / /

> The proposed restructuring provides for an increase in the formula for calculating benefits . . . . This increases the cost to the System to pay the benefit, which increases liabilities since no contributions have been received in the past to fund the benefit at this level. This is what is known as past service liability. The actuary has estimated the amount of past service liability created by the restructuring proposal to be $76.7 million expressed in 1996 dollars.

Ex. 43.3.

Under the "restructuring," neither these past benefits nor the future benefits are funded at the actuarially recommended rate; rather,

> [t]he restructuring proposal provides that the employer contribution rate will be "ramped up" to the actuarially recommended rate in increments over the next 10 years. This means that the System will be receiving less in contribution dollars over that period, which creates an additional liability.

Id. at 43.3.

The combination of benefit increases and reduced contribution had a significant fiscal impact: "The actuary has estimated the amount of contribution shortfall liability created by the restructuring proposal to be $30.0 million expressed in 1996 dollars." *Id.* Thus, the "increased liabilities associated with the restructuring proposal [are] in the amount of $106,700,000." *Id.* This was dealt with by charging the monies against the "surplus" undistributed earnings in the System. *Id.*

Finally, the memo concludes:

> TOTALITY OF THE PROPOSAL
>
> If necessary contingencies identified to approve this Proposal in its entirety are not affirmatively met by January 1, 1997, then:
> . . .
>
> B. The CERS benefit improvements listed in Issue No. 2 above would not occur;
>
> C. The employer contribution rates to be paid would be those established by the System's Actuary.

Id. at 43.4.

On the same day as this Memorandum, June 21, 1996, the SDCERS Board met to consider the Proposal. Ex. 276.118-276.163 (SDCERS Board Meeting Minutes 6/21/96). The

Board's Agenda Item addresses both contributions and benefits: "CITY MANAGER'S PROPOSALS REGARDING CONTRIBUTION RATES, BENEFITS AND DISTRIBUTION OF EARNINGS." Ex. 276.129. The plan was described by Mr. McGrory:

> Mr. McGrory spoke to the revised City Manager's proposal . . . . He stated that over the past few years, there have been ongoing discussions between the City Manager's Office and the Retirement Board regarding funding of the retirement system . . . [including] benefit levels for retirees in terms of benefits and the 13th check; and general member benefit levels. Concurrently, the City Manager's office has had concerns regarding the way the City's contribution rate into the System has been calculated . . . . [T]he City's contribution rates have been driven up to a level unanticipated by the City, and the level of fluctuation in these rates have [sic] caused tremendous problems in terms of year-to-year budgeting. Mr. McGrory reported that after extensive discussions with members of the Board, employee organizations, a series of fiduciary counsels, and the System's actuary the draft Manager's proposal has come back to the Board with recommended benefits improvements . . . .

Id. at 276.129. Mr. McGrory looked to the system's existing assets to resolve these twin objectives of increasing benefits while decreasing the employer contribution:

> [W]ith the System's level of earnings, he believes that in terms of timing and the historic level of earnings, this is a unique window of opportunity to implement such changes . . . . Mr. McGrory stated that although the decision remains with the Board, the City Manager's office is asking that the Board approve the proposal in concept today . . . . Additionally, he stated the Manager's office is recommending that the Board increase the retiree benefit this year . . . .

Id. at 276.130.

Mr. McGrory concluded his remarks to the Board by discussing the funding for the restructuring, and then making clear that the employee benefit increases were wholly contingent on the Board's approval of this complete "package":

> Mr. McGrory stated that their proposal addresses how liabilities would be paid and the restructuring proposal in terms of ramping-up the City's actual recommended rate in increments of 10 years. This would be accomplished by taking the funding (the surplus earnings between 1995 and 1996 of $38.8 million and $85 million), along with the stabilization reserve (which was created last year) for a total of $135 million. He stated that $30 million of that would be for the City's contribution gap between what they would ramp-up in the budget and the actuarial rate, with the

> remainder to be used to pay for the past liability incurred by the benefit improvements. He stated that prospective liabilities would be paid for by an equal increase in both the employer and employee contribution rate.
>
> Additionally, the City Manager's Office is asking that the Board adopt the budgeted FY 96 and the recommended FY 97 rate. He reminded the Board that this must be treated as a package. If this is not approved, he stated that come January, 1997 the City would repay the contribution rate gap for 1996 and 1997, and none of the benefit improvements would occur.

Id. at 276.131.[2]

This presentation was followed by a Motion to Approve the City Manager's Proposal dated June 21, 1996. *Id.*

In the ensuing discussion, Board Member Paul Barnett asked whether fiduciary counsel, Mr. Hamilton,

> was troubled by the fact that the Board would be agreeing to allow the System to remain under-funded by a considerable amount and using the system's surplus to help pay for additional benefits and assisting the employer with their contributions rates.

Id. at 276.133. Mr. Hamilton responded by saying that "he would like to address the package as a whole" "[b]ecause this is being presented as a comprehensive package . . . ." *Id.* He indicated that the Board has a fiduciary duty to determine the appropriate funding level deemed necessary to provide for the additional benefits. *Id.* He further stated "that there needs to be something in this proposal that assists the City" and therefore the "question is whether the contribution rate

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[2] As the actual transcript of the June 21, 1996 SDCERS Board meeting reflects, Mr. McGrory's full statement to the Board on this point was as follows:

> And this is a package. What we are asking you to do today is to adopt the budgeted rate that we have for fiscal year 1996, this fiscal year, adopt the rate that we have recommended in our package for fiscal year 1997, that this has to be treated as a package. And if the benefits in the package as a total is not approved, then we would then repay the contribution rate gap for '96 and '97 in January 1997 and none of the benefits would take place, none of the benefits improvements, so the entire package would unwind.

Ex. 271.2, Track 5 (6/21/96 SDCERS Board Meeting Transcript) and Ex. 1082.1 (audio excerpt).

stabilization plan as advocated by the City Manager, is something that the Board can live with . . . ." *Id.* at 276.134. He took comfort in the sunset provision that would trigger an increase to the actuarial rate if there was more than a 10% drop in the funded ratio. *Id.*

In response to a question from Board Member Wilkinson, Mr. Roeder, the system actuary, confirmed that the proposal would result in an immediate "5% drop in the [System's] funding level because . . . the System will immediately recognize approximately $77 million in accrued liabilities related to the increased benefits for past service." *Id.* at 276.140.

"Since . . . the City Manager has indicated that this is one integrated, 'take-it' or 'leave-it' package," Ms. Wilkinson questioned what action the Board could take on this proposal that day. *Id.* at 276.141. The Chair, Mr. Enerson, confirmed that the City Manager "has presented this proposal as a package deal." *Id.* The System Administrator, Mr. Grissom, advised that the Board had the "authority to make a determination in agreement with the City on how the rates will be paid." *Id.* at 276.143.

The Board also heard testimony from union representatives, urging the Board to approve this proposal "as a means to allow the general member's benefit levels to be increased . . . ." *Id.* at 276.147.

Part of the record of this Board proceeding is the opinion of the Board's fiduciary counsel. In a letter dated June 21, 1996, counsel notes that the liability to the system created by the past service liability will be $76.7 million, plus $30 million in contribution shortfall liability:

> No contributions have been received in the past to fund the increased benefits, and thus the result is an increased liability [of $76.7 million]. The City Manager's Employer Contribution Rate Stabilization Plan provides for the employer contribution rate to be incrementally increased to the actuarially recommended rate over the next ten years. As a result, the System will be receiving less in contribution dollars over that period, which creates an additional liability. The actuary estimates that the amount of contribution shortfall liability created . . . is $30 million expressed in 1996 dollars.
>
> The total of estimated increased liabilities associated with the City Manager's proposals is $106,700,000 . . . .

Ex. 276.157-276.158.

/ / /

Finally, another letter from fiduciary counsel linked the benefits increases and the underfunding: "The modification and increase of benefits, as set forth in Issue No. 2 of the City Manager's proposal . . . ***is contingent upon*** the Board's approval of Issues No. 3 and 4 [relating to funding]. Ex. 84.5 (emphasis added).

At the conclusion of the June 21, 1996 SDCERS Board meeting, the Board passed the Manager's Proposal, now known as MP I, by an 8-3 vote, with SDCERS Board Members Terri Webster, Sharon Wilkinson, Ron Saathoff and John Torres providing the swing votes in favor of MP I. *Id.* at 276.148. These individuals were also City employees and direct beneficiaries of the benefit increases in the proposal. *Id.*

On July 2, 1996, the City Council adopted Resolution No. 287582, adopting the Manager's Proposal. Ex. 155. That Resolution reflects that the unions agreed to the proposed benefit increases "subject to the occurrence of various contingencies contained within the proposal." Ex. 155.1. The resolution therefore approves the benefit increases "contingent on an affirmative vote of the participants." Ex. 155.2. Each of the Management Proposals to the unions was conditioned upon the union's acceptance of the Manager's Proposal to SDCERS. *See* Ex. 155.12, 155.20.

Throughout this process of consideration, adoption and implementation of MP I, in addition to the participation of SDCERS Board members (such as Saathoff, Webster, Wilkinson and Torres) who personally gained from the benefit increases, several City personnel (such as Bruce Herring and Cathy Lexin) who also would profit from the benefits directly were involved in the development and adoption of MP I. *See*, *infra*, at 67-69.

In short, the record of proceedings demonstrates that MP I was a "package" deal, in which benefit increases were linked to funding concessions. The benefits increases in the implementing legislation and MOUs were part of an integrated plan developed by certain City officials, which was contingent upon the funding relief provided by the SDCERS Board. The direct beneficiaries of the resulting City employee benefit increases included the City employees who developed and facilitated the plan, including Herring, Lexin and the four SDCERS Board Members who cast deciding votes in favor of the deal. The agreement allowed a drastic

reduction in the City's funding of the pension system, including years of employer contributions below the actuarially-required rate.

B. Manager's Proposal II

The underfunding seeds planted in MP I bore bitter fruit as the economic boom years of the mid-1990s (which had created the cushion available to fund the benefit increases and "contribution stabilization" in MP I) were succeeded by the events of September 11, 2001, the bust of the dot-com stock market and shortfalls in state funding. This confluence of events, and the resulting downward spiral in system funding, which threatened to "trigger" a City balloon payment, led to MP II, a second Manager's Proposal, in 2002. The official record shows that MP II again involved increased benefits coupled with funding reductions. The record also shows that it was virtually the same group of SDCERS Board members and City officials who developed, approved, and implemented MP II.

On or about June 10, 2002, the City Manager proposed that MP I be modified to establish a 75% floor for the actuarial funded ratio of SDCERS—a further decrease below the 82.3% "trigger" adopted in MP I. Ex. 276.179. This ***decrease*** in funding requirements was to be coupled with another ***increase*** in the General Member benefit rate. Exs. 276.179, 272, 274, 311 and 357. The unions again were participants in the process. For example, the letter of May 13, 2002, from the City's labor negotiator, Dan Kelley, to union president Judith Italiano states:

> Substantial benefit improvements granted by the City since the adoption of the "City Manager's Retirement Proposal" dated July 23, 1996 (Manager's Proposal) have created additional unfunded liability to SDCERS that was not anticipated when the City agreed to the "trigger" provisions.

Ex. 272.2. Further,

> [s]ignificant improvements in benefits are contained in this three-year proposal. Consequently, the "trigger" provisions must be adjusted as a condition of the City's three-year proposal. Therefore, this three-year proposal is ***contingent*** upon, and subject to, approval by the SDCERS Board of Trustees of an adjustment to the "trigger" provisions contained in the Manager's Proposal, Issue #3, Paragraph B . . . .

Id. (emphasis added).

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The original MP II plan was modified in a June 18, 2002 City Manager's Memorandum. Ex. 276.179. The revision was in reaction to the draft opinion of the system's fiduciary counsel, Robert Blum, "that if the Board adopted the Manager's proposed amendment of June 10, it may create a material risk that a court may consider such an approval not a prudent exercise of the Board's fiduciary responsibilities." Ex. 276.187. To address that concern, the City offered to double the incremental increases in the agreed to City contribution rates beginning in fiscal year 2005. *Id.* at 1350.1. As before, the benefit increases were an integral part of this amended proposal:

> The City paid rate would increase 0.50% in FY03, increase 0.50% in FY04 plus + 1.06%, the cost of the 2.5% at age 55 formula; then increase 1.00% beginning in FY05, and continue with 1.00% increases until the City is paying the PUC rate, then continue with 0.50% increases until the City is paying the EAN actuarial rate.

Id. at 1350.2.

On June 21, 2002, the SDCERS Board took up the revised Manager's Proposal. The Agenda Item was titled: "REQUESTED ACTION REGARDING THE CITY MANAGER'S REQUEST TO MODIFY THE 1997 MANAGER'S PROPOSAL." Ex. 276.179. The Deputy City Manager, Bruce Herring, presented

> his proposal . . . in the context of some labor negotiations that were recently completed with most of the City's employee labor representatives. What [Herring] is presenting today are the implications of these negotiations as they relate to the System and its funding trigger. Although they are separate issues, they are tied into the tentative labor agreements.

Id. In addition to sponsoring this proposal before the SDCERS Board, Herring again served on the meet and confer team with the unions in 2002. *See*, *infra*, at 68-69.

Similarly,

> Mr. Grissom reported that these issues evolved out of the meet and confer process [between the City and the unions], in which a number of ***benefit enhancements were agreed upon, but made contingent upon the Board's approval of the Manager's funding proposal . . . . What the City is asking the Board to do is approve . . . a funding mechanism that would allow these benefit enhancements to be conferred.***

Id. at 276.180 (emphasis added).

This prompted the System's actuary, Mr. Roeder, to express caution regarding the conflict of interest issue because benefits and funding should be separate:

> He offered a long-term perspective of what's been happening over the past ten years. In isolation, there is nothing wrong with enhanced benefits, which people tend to favor. There is also nothing wrong with contribution relief—in isolation. However, when enhanced benefits come at the same time as contribution relief, the Board must be cautious. The Manager's Proposal has been in effect for five years, which has allowed the City to pay less than the actuarially assumed rate. The role of a fiduciary must be independent of the setting of existing or potential benefits. He can only urge that in the future, those two functions be truly segregated.

Id. at 276.180. Mr. Roeder also pointed out that the City is the only public employer in the state to use the less conservative PUC actuarial funding methodology, and he warned that

> SDCERS has one of the lowest funded ratios in California. The gap between the PUC actuarial rate and the City's contribution has also increased and is now bigger than it was when the Manager's Proposal [I] was implemented.

Id. at 276.181. Mr. Roeder also stated:

> He is concerned with the new proposal because of the coupling of benefit increases to funding, along with the significant change from the 82.3% safeguard to 75%.

Id. at 276.182.

Fiduciary counsel, Mr. Blum, echoed Mr. Roeder's warnings:

> [He] said the proposal posed a material risk if this were litigated in court. The judge could find that approval of the proposed amendment to the 1996 Proposal was not a prudent exercise of the Board's fiduciary duties, which would be based on the facts before the Board and fiduciary counsel at that time. In 1996, the Board agreed to an annual contribution rate that the City would make, which would in fact be lower than required under the actuarial valuation, using PUC . . . .
>
> Today, there is a different actuarial and economic situation. Mr. Blum said the actuary has told a very different story today than what the Board heard with the 1996 proposal. At that time, part of the benefits and contribution rate changes were approved, based on the fact the System had $105 million in surplus earnings . . . . Currently he and Ms. Hiatt are concerned about the lack of process the Board has undertaken at this point. In a worse case scenario, the Board and City could be sued . . . . If this were to happen, a number of things could occur. The judge could tell the Board anything from reconsidering its action all the way up to holding

> each Trustee personally liable for losses . . . . It is process that will get the Board out of the awkward position it has been put in. Similarly, this process will get the City and its employees out of this awkward position.
>
> . . .
>
> This requires appropriate review of the materials and ensuring that appropriate funds are contributed to SDCERS. The Board must also decouple negotiations and fiduciary decisions. One of the reasons this is such an awkward situation is that these two things have been brought together, which is very unfortunate . . . . The fact this year's proposal was coupled with negotiations was quite inappropriate. The Board's job is to administer the fund to the best of its ability and set standards, not to negotiate benefits.

Id. at 276.187-276.189.

After this discussion, and a question about whether the City could indemnify the Board if the Board breached its fiduciary duty, the motion to approve the proposal was amended to trail the item, and to hold a special meeting for the trustees to submit their concerns to staff. *Id.* at 276.192. The Board then voted to continue the matter. *Id.* at 276.195.

A subsequent City Memorandum, dated July 3, 2002, supplemented the Manager's Reports dated June 10 and June 18. Ex. 1350. Included with that memo as Attachment 1 were answers to the Board members' questions. Trustee Richard Vortmann asked "the Manager to explain why the Board was put in the middle of labor negotiations, and how we will conduct union negotiations in the future differently to prevent this inappropriate situation." *Id.* at 1350.3 (Question 2). The answer given in part was:

> Aware of the effect of the market decline and reduced SDCERS earnings during FY2002, the City developed concerns about a further decline in the funded ratio for the June 30, 2002 valuation and became concerned about the effect of "triggering" the full actuarial rates in FY04 contemplated in the 1996/97 Manager's Proposal.
>
> The City, through labor negotiations, agreed that the 2.50% at age 55 [increase] is an appropriate benefit to bestow. The City, however, was not willing to grant this benefit, given the cost, if at the same time, it might be facing a jump in retirement contribution which would further modify the rates to full actuarial rate (+$25 million) as a result of the "trigger." Consequently, the City agreed ***contingent*** upon the resolution in this proposal.

Ex. 1350.4 (emphasis in original).

The City Council was kept apprised of the MP II-related developments at the SDCERS Board. By a July 8, 2002 memorandum, entitled "Contingent Retirement Benefits and Proposal to SDCERS," the City Council was informed that "[t]he 'draft' report from fiduciary counsel published for the June 21, 2002, meeting was quite negative, clearly erring on the side of caution due to the fact that counsel, from his perspective, did not have time to evaluate the proposal sufficiently to render final advice." Ex. 277.

The Council was further informed that staff "anticipate a motion from a board member which would further modify the proposal before the Board, by eliminating the request to lower the funded ratio floor, and including the five year phase in if the trigger (82.3% funded ratio) is effectuated." Ex. 277.2.

In the July 8 memorandum, staff "recommended that the Council authorize staff to agree to this modification should the proposal currently before SDCERS not prevail." The Council was further informed that "the practical impact on the City would be no different that the previously authorized City position. Under either scenario, there would not be any increase to the City contribution rate until FY05." Ex. 277.2.

On July 9, 2002, the City Council, in closed session, authorized city staff to accept the modified version of the MP II proposal "but only as backup if original proposal (75% trigger) fails at Retirement Board." Ex. 373.

On July 11, 2002, MP II again came before the SDCERS Board for approval. As predicted in the July 8, 2002 memorandum, a SDCERS Board Member, Ron Saathoff, made a substitute motion that further modified the proposal before the Board by eliminating the request to lower the funded ratio floor, but including the 5-year phase in if the trigger was hit. Ex. 276.234.

In the Board Minutes, on the Agenda Item captioned, "REQUESTED ACTION REGARDING THE CITY MANAGER'S REQUEST TO MODIFY THE 1997 MANAGER'S PROPOSAL," Ex. 276.203, Mr. Grissom confirmed at the outset the link between the Board's action and the benefit increases:

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> He explained that during this year's meet and confer process, the City and Labor Organizations agreed to some ***benefit enhancements which were subject to the Board's approval of a modification of the 1996-1997 Manager's Proposal***. He informed the audience that it is not the Retirement Board's role or function to approve benefits . . . . The issues the Board will be addressing today are those related only to the financing of those benefits, employer contributions and how they are paid.

Id. (emphasis added).

A lengthy discussion ensued. During that discussion, then-private attorney Michael Aguirre advised the Board that the connection between the underfunding and the benefits placed the Board in an impermissible conflict of interest situation. *Id.* at 276.222.

On the other side, Ann Smith, representing the MEA, supported MP II, saying that it "is an important part of MEA's analysis to seek benefit improvements which includes doing its own analysis, to retain its own advisors regarding the City's budget," to protect the represented employees. *Id.* at 276.223. She stated: "Having reviewed the Manager's proposal, MEA has confidence in the integrity of what is being presented." *Id.* "She [assured] the Board that its support for the Manager's proposal is important to 5,000 represented employees. MEA has confidence with its analysis that this is an appropriate proposal." *Id.*[3] Another union representative, Ed Lehman, spoke in support of MP II, as well. *Id.*

In response to an objection that this proposal tied underfunding to benefits, Ms. Lexin invoked the MP I precedent, observing that there

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[3] Contrary to Ann Smith's statements to the Retirement Board, Judith Italiano, former MEA President, testified that MEA did not conduct any independent analysis regarding the feasibility of the City Manager's proposal. *See* Tr. Nov. 7, 2006 p.m. 76:6-20 ("Q. All right. Now, did you do something in 2002 to determine . . . whether that proposal would, in fact, achieve . . . the actuarial funding of the system? . . . A. We attended any meetings where they were discussed, we listened to the presentations that were made by the City. ***We did not do any independent checking on what was being presented, no.***") (emphasis added); *see also id.* at 77:14-22 ("Q. Okay. But – would it be also fair to say that with regard to any of this, the analysis that Mr. Herring was presented, and the feasibility of it, there was no independent analysis done by M.E.A. with regard to those representations? A. No, he – no. The City did their own analysis. Q. But – but ***would it be fair to say the M.E.A. did not do their own? A. We did not.***")

> ***were substantial retiree and active member benefits tied to the 97 MP [MP I] and consideration was given to the employer that all three occurred at the same time and contingent upon each other.***

Id. at 276.226 (emphasis added).

A Motion was made to support the Proposal. *Id.* at 276.227. In the Board's second discussion, the actuary (Mr. Roeder) noted:

> [He] was more comfortable with the original proposal [MP I] because there were some safety nets that provided enough confidence that if hard times hit, the funding integrity of the System would not be negatively impacted. However, times are much different now. As such, he can't give the Board assurance today.

Id. at 276.227-276.228. The Motion to Approve the Manager's Proposal was then amended, to make Board approval contingent upon receiving "acceptable, written confirmation from the City that it would indmenifiy [sic] trustees in any lawsuits arising out of actions being taken by this Board." *Id.* at 276.230 (capitalization omitted).

Fiduciary counsel, Mr. Blum, then restated his opinion as to the June 18, 2002 proposal, as to whether counsel "thinks the Board would be sued if the proposal were approved." *Id.* at 276.232. "His response is, yes, there is a material risk that the court could find that the Board didn't fully exercise its fiduciary responsibilities in approv[ing] this." *Id.*

After this advice, Board Member (and union president and City employee) Ron Saathoff brought the substitute motion in lieu of the June 18 Manager's Proposal. Mr. Saathoff moved to modify MP II to provide for an incremental payment schedule once the 82.3% trigger was hit, and other terms, which would include the benefit increases, all contingent upon a satisfactory written agreement between the City and the Board. *Id.* at 276.234.

Although hesitant to provide an "on the fly" opinion, Mr. Blum proceeded to do so, saying he was "much more comfortable" with this motion. *Id.* at 276.239. With little further discussion, the Board approved the modified proposal. *Id.* The Board voted 8-3 in favor, passing the motion, with Saathoff, Vattimo, Wilkinson, Torres, Webster and Lexin voting in support. *Id.* These Board Members, whose votes allowed passage of MP II, were all City

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employees and direct (and special) recipients of the benefit increases provided as part of the package.

In a July 12, 2002 "Hotsheet," MEA members were informed "the San Diego Retirement Board of Trustees approved the City Manager's request to allow the city to ramp up their contributions over the next 7 years." Ex. 331. The "Hotsheet" informed the MEA members that "City Manager Mike Uberuaga has informed MEA that the 'motion approved by the Retirement Board was within the authority the Council has given him" and therefore he felt the "contingencies of our ratified agreement had been met and we had an agreement." Ex. 331.

The agreement was then legislatively approved. On October 21, 2002, the City Council approved a resolution adopting the "Presidential Benefit," allowing the handful of employees who served as union presidents—one of whom was Mr. Saathoff—to receive pension benefits based upon their union salary, in addition to any City salary, Ex. 61 (Res. No. 297212), and adopting the Memorandum of Understanding ("MOU") with the unions, which was contingent upon funding relief by SDCERS. Ex. 73 (Res. No. 297213).

On November 15, 2002, the SDCERS Board approved the final terms of the MOU with the City. On November 18, 2002, the former City Council approved the resolution confirming the indemnification of the SDCERS Board Members. Ex. 108 (Res. No. 297335). That same day, the Council approved the resolution authorizing the City's agreement with SDCERS on MP II, as previously approved by the Board. Ex. 1168 (Res. No. 297336).[4]

Finally, two Ordinances were passed, amending the Municipal Code. The first, Ordinance No. 19121, adopted November 18, 2002, implemented the SDCERS/City MOU and provided that the Municipal Code would be amended (in Section 24.0801) to provide that the City's contributions to the Retirement System will be based upon the terms of the Memorandum

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[4] The record shows that the Board approved MP II on July 11, 2002, *see* Ex. 276.239 (July 11, 2002 Minutes), several months before the City Council approved the resolutions enacting the Presidential Benefit, Ex. 61 (Res. No. 297212, passed Oct. 21, 2002), adopting the MOU with the unions, Ex. 73 (Res. No. 297213, passed Oct. 21, 2002), and approving the indemnification of the Board members, Ex. 108 (Res. No. 297335, passed Nov. 18, 2002).

of Understanding between the Board and the City, rather than the previous Municipal Code section that required actuarially-approved funding. Ex. 74.2. The "Retirement Board's Assistant General Counsel prepared this ordinance to amend the Municipal Code to make the changes agreed to by the City's Management Team and the four labor organizations and approved by the City Council . . . ." *Id.* at 74.3. This ordinance also implements the benefit increases agreed to in MP II, including the increase in the General Member Retirement Calculation Factor. *Id.* at 74.9. A second Ordinance, adopted on December 3, 2002, provided benefits specifically to Firefighters Local 145, headed by Mr. Saathoff. Ex. 107 (Ord. No. 19126).

Thus, the record shows that MP II was an outgrowth of MP I, developed, sponsored and approved by the same cast of City officials and SDCERS Board members—Herring, Lexin, Webster, Saathoff and Wilkinson—who had facilitated MP I and who each stood to benefit from MP II, as well.

III.

PROCEDURAL HISTORY

This lawsuit originally was filed by SDCERS on January 27, 2005 as a claim for declaratory relief and preliminary injunction, relating to the issue of the retirement system's legal counsel. In response, the City and San Diego City Attorney Michael J. Aguirre ("Aguirre") cross-complained against SDCERS, *et al.*, seeking, *inter alia*, a judicial declaration that certain City employee retirement benefits are the result of illegal transactions and therefore void, and a writ of mandate barring further payment of those benefits.

The City's pleadings have been amended several times in response to motion practice, and the City currently has pending its 5ACC, which asserts two separate causes of action for declaratory relief against SDCERS—the first seeking a declaration that MP I was illegal and void, and the second seeking a declaration that MP II was illegal and void.[5]

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[5] In its original form, the 5ACC also stated a claim for writ of mandate against SDCERS and City Auditor/Comptroller John Torrell, enjoining further payment of the illegal benefits. That cause of action was dismissed pursuant to a stipulation between the City and SDCERS, which was filed on October 23, 2006.

In addition, on July 26, 2005, SDCERS filed a new action for declaratory relief, entitled *San Diego City Employees' Retirement System v. City of San Diego*, San Diego Superior Court Case No. GIC851286, seeking the opposite relief as requested by the City and Aguirre in their cross-complaint, *i.e.*, that the benefits were lawful and could continue to be paid.[6]

In August 2005, over City opposition, the unions representing City employees and SDCERS pension beneficiaries, including MEA, American Federation of State, County and Municipal Employees ("AFSCME") Local 127, and San Diego City Firefighters Local 145 (collectively, the "Unions"), were granted leave to intervene in support of SDCERS. The Unions' complaints in interventions seek, *inter alia*, a declaration that the benefit increases awarded under MP I and MP II, as well as implementing agreements and legislation, are lawful despite the alleged violation of state conflict of interest laws.

At or around the same time the Unions intervened, former City Clerk Charles Abdelnour and numerous individual non-union employees and retirees filed a third lawsuit against the City entitled *Abdelnour, et al. v. City of San Diego,* San Diego Superior Court Case No. GIC852100, alleging one cause of action for declaratory relief, and requesting a judicial determination that SDCERS may legally pay all contested pension benefits. The *Abdelnour* case was consolidated with Case No. GIC851286, which was then consolidated with Case No. GIC841845.

The Court has heard numerous pretrial motions. In particular, the Court decided extensive cross-motions for summary judgment or summary adjudication, and denied those motions finding that there were fact issues requiring trial. In an order entered on September 15, 2006, and supplemented by a pretrial conference hand-out on October 26, 2006, the Court granted the Unions' request for phased trial proceedings and divided the case into three phases, with the following issues to be heard in Phase I:

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[6] Subsequently, in support of its Motion for Summary Judgment, SDCERS clarified that it was not seeking a declaration that the benefits were legal but, rather, a declaration that SDCERS had paid and could continue to legally pay the benefits until such time as they were repealed or voided by the Court.

1. Whether the Fifth Amended Cross-complaint presents an actual and justiciable controversy between the City and necessary parties (relating to the indispensable parties issue);

2. Whether the Fifth Amended Cross-complaint presents an actual and justiciable controversy on which the Court can render a meaningful, concrete and specific decree (relating to the issue of what remedy is sought by the City and whether it is possible under the circumstances of this case);

3. Whether the City's claims that MP I and MP II are null and void are barred because of the *Gleason* settlement and litigation;

4. Whether the City can pursue a claim that SDCERS violated the Debt Limit Laws; and

5. Whether the City is estopped as a matter of law from challenging the MP I benefits by the prior judgment in *Corbett*.

Phase II will address statute of limitations defenses and Phase III will determine all remaining issues, including the central questions relating to the allegedly invalidating conflicts of interest.

Trial on Phase I commenced on October 26, 2006, and concluded on November 29, 2006. After considering the testimony and evidence, the law, and the parties' arguments, the Court now issues this Statement of Decision on the Phase I issues listed above.

IV.

THE FIFTH AMENDED CROSS-COMPLAINT PRESENTS AN ACTUAL, JUSTICIABLE CONTROVERSY BETWEEN THE CITY AND NECESSARY PARTIES

The Court has determined that the 5ACC does present an actual and justiciable controversy between the City and the parties before the Court, and that complete relief can be accorded to those already before the Court. Any judgment by the Court can be shaped to eliminate undue prejudice to absent parties.

California Code of Civil Procedure Section 389(a) defines parties necessary to an action:

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> [A person] shall be joined as a party in the action if (1) in his absence complete relief cannot be accorded among those already parties or (2) he claims an interest relating to the subject of the action and is so situated that the disposition of the action in his absence may (i) as a practical matter impair or impede his ability to protect that interest or (ii) leave any of the persons already parties subject to a substantial risk of incurring . . . inconsistent obligations.

Cal. Civ. Proc. Code § 389(a). *See generally Olszewski v. Scripps Health*, 30 Cal. 4th 798, 808-809 (2003).

Even if a determination of necessity under Section 389(a) is made, however, the Court has the broad discretion to maintain the action. *E.g.*, *Koster v. County of San Joaquin*, 47 Cal. App. 4th 29, 44 (1996). Section 389(b) states, "[i]f a person described in paragraph (1) or (2) of subdivision (a) cannot be made a party, the court shall determine whether in equity and good conscience the action should proceed among the parties before it . . . ." Courts "should, in dealing with 'necessary' and 'indispensable' parties, be careful to avoid converting a discretionary power or a rule of fairness in procedure into an arbitrary and burdensome requirement which may thwart rather than accomplish justice." *Bank of Cal. Nat'l Ass'n v. Super. Ct.*, 16 Cal. 2d. 516, 521 (1940). Parties should be joined "unless it is impossible to find them, ***or impracticable to bring them in***. But it is a matter of discretion whether or not to proceed without them." *Leonard Corp. v. City of San Diego,* 210 Cal. App. 2d 547, 551 (1962) (emphasis added); *see also People ex rel. Lungren v. Cmty. Redev. Agency for City of Palm Springs*, 56 Cal. App. 4th 868, 875-76 (1997) ("It is for discretionary and equitable reasons, not for any want of jurisdiction, that the court may decline to proceed without the absent party.") (quoting *Kraus v. Willow Park Public Golf Course*, 73 Cal. App. 3d 354, 368 (1977)).[7]

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[7] Among the factors the Court considers in exercising that discretion are:

- The extent to which prejudice may be avoided by protective measures;
- Whether the judgment rendered in the nonjoined person's absence will provide an adequate remedy to the parties before the Court; and
- Whether, if the action is dismissed for nonjoinder, the plaintiff will have an adequate remedy elsewhere.

In this case, as detailed below, the Court finds that the absent parties are not necessary within the meaning of Section 389(a), and, in all events, even if such parties were "necessary," they are not indispensable, and the Court may proceed in the exercise of its discretion under Section 389(b).

A. The Requirements of Section 389(a) Are Satisfied

Given the matter in dispute, the Court has determined that a form of complete relief can be accorded among those already parties sufficient to comply with Section 389(a). In view of the existing parties to the case, the public interest and the protective steps available to the Court, the Court finds that the disposition of the action will not as a practical matter impair or impede the ability of an absent party to protect its interest. Moreover, SDCERS and the City have agreed to be bound by the judgment of the Court and accept the risk of multiple or inconsistent judgments.

1. Complete Relief Can Be Accorded Among the Parties

As discussed in detail below, the City seeks to set aside contracts and legislative actions the City claims were adopted in violation of multiple laws prohibiting public officials from engaging in official action in which they have a financial interest. *E.g.,* Cal. Gov't Code §§ 1090, 87100; San Diego City Charter § 94. Under the law urged by the City, contracts or legislation adopted in violation of such laws are not merely voidable, but void. Cal. Gov't Code § 1092. The City is also asking the Court to set aside official actions taken in violation of the debt limit laws. Again, the remedy provided is to set aside the offending actions irrespective of the parties affected. Cal. Const., Art. XVI, § 18; San Diego City Charter § 99.

If City officials violated the applicable provisions of law, the mandatory remedy requires that the official actions be set aside. ***That result will not vary based upon the identity or interest of any absent parties: The law requires invalidation of the official action irrespective of the individual impact that would follow.*** Thus, under the laws asserted by the City, a single party

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See Olszewski v. Scripps Health, 30 Cal. 4th at 808; *Deltakeeper v. Oakdale Irrig. Dist.*, 94 Cal. App. 4th 1092, 1106-1108 (2001).

would be entitled to the relief sought if it be shown that the conflict of interest or debt limit laws were violated. Given the appropriate judicial remedy (discussed *infra*), which entails a declaration of invalidity of official actions tainted by conflict of interest or other legal violations, and a remand to the legislative body for new proceedings, complete relief can be afforded among the parties before the Court without undue prejudice to absent parties.

Indeed, in cases of public interest such as this, traditional rules of party joinder do not apply. As the Ninth Circuit Court of Appeals wrote in *Kettle Range Conservation Group v. U.S. Bureau of Land Management*:

> It appears clear that if, as appellants urge, the only "complete" relief the district court could grant was to rescind the already executed contracts and invalidate the private entities' title to the transferred land, those private entities would, ordinarily, be necessary parties under Rule 19. The federal rules have, however, recognized a "public rights exception" to the usual rules of joinder when "litigation . . . transcend[s] the private interests of the litigants and seeks[s] to vindicate a public right . . . . [In cases] involving the protection and enforcement of public rights "there is little scope or need for the traditional rules governing the joinder of parties in litigation determining private rights."

150 F.3d 1083, 1086-87 (9th Cir. 1998) (citations omitted).

California law follows the same rule. *See People ex rel. Lungren v. Cmty. Redev. Agency*, 56 Cal. App. 4th 868, 882 (1997). As that court wrote:

> [T]he interest the public has in obtaining some level of review of the actions of the Agency in transferring property and placing it beyond the reach of the state's police power is sufficiently important that it provides an exception to the general application of the rule, under section 389, that an action challenging a contract should be dismissed if a party to the contract cannot be joined as a party . . . . [T]he court must recognize the interests of the citizens . . . in providing some review of the power of a local agency to permanently relinquish its interest in property within its control.

Id.

Because the remedy discussed below is one that confines the relief to the broad question of the unlawfulness of the official action and then provides for remand for further legislative, administrative or judicial proceedings as appropriate, the beneficiaries' interests are fully represented in this case by the existing parties, and there is nothing to preclude this Court from

determining the fundamental conflict of interest issue. *See Fraser-Yamor Agency, Inc. v. County of Del Norte*, 68 Cal. App. 3d 201, 214 (1977), *superseded by statute on other grounds as stated in People v. Honig*, 48 Cal. App. 4th 289 (1996) (where parties to a contract tainted by a conflict of interest were not joined to lawsuit, court could still adjudicate issue of whether there was an illegal conflict of interest under Section 1090).

2. The Unions and Other Parties Represent the Absent Parties

The ability of the absent parties to protect their interests is not impaired or impeded by this action because they are well represented by multiple existing parties to this action. Parties are not necessary under Section 389(a) when they already are fairly represented by existing parties to the action. *See Citizens Ass'n for Sensible Dev. of Bishop Area v. County of Inyo*, 172 Cal. App. 3d 151, 161 (1985); *see also Deltakeeper*, 94 Cal. App. 4th at 1102 (a nonjoined party's ability to protect its interest is not impaired or impeded as required by Section 389(a) when a joined party has the same interest in the litigation). Here, the absent parties—pension beneficiaries—are well represented by the existing parties—the Unions, SDCERS and the Abdelnour Plaintiffs.

a. The Unions Represent All Employees

Given principles of representational standing, the Unions have standing to sue and to obtain binding determinations on behalf of their individual members (and even those who are not members), and therefore the individual employees do not need to be parties to the litigation. *See Int'l Union, United Auto., Aerospace & Agricultural Implement Workers of Am. v. Brock*, 477 U.S. 274, 287-90 (1986). In *Brock*, the United States Supreme Court addressed associational standing by unions in cases brought on behalf of their members and representing their members' individual interests. The Court held that the unions had standing to litigate the legality of legislation impacting union members, even without the joinder of the members in the lawsuit. *Id.* Because the lawsuit turned upon a question of statutory interpretation, and because the application to individual members' benefits would have to be considered by proper state authorities before the member could receive the benefits allegedly due him, the union could "litigate this case without the participation of those individual claimants . . . ." *Id.* at 288.

Indeed, the Court noted, one of the advantages for an employee in joining a union is that members may pool capital and resources and thereby obtain better legal representation of their interests than a member could obtain individually. *Id.* at 289-90. Thus, under established federal rules of representational standing, unions may seek a determination on behalf of their members as to their individual rights to benefits under law. *See also Rhode Island Bhd. of Corr. Officers v. Rhode Island*, 357 F.3d 42, 48-49 (1st Cir. 2004) (union had standing to seek declaration on behalf of its members as to whether Contract Clause protected rights to particular pay under alleged individual contracts; held no such protection applied because contracts did not give rise to obligation).

The same rule governs under California law. In *Professional Fire Fighters, Inc. v. City of Los Angeles*, 60 Cal. 2d 276, 284 (1963), for example, the court held that the union could seek declaratory and injunctive relief for discrimination against individual union members. The court wrote:

> [U]nions such as plaintiff may be organized for the sole purpose of representing their members. An action at law on behalf of such members is one form of such representation . . . . [Plaintiff union's] members are all employees of the fire department and as such have a clear beneficial interest in the subject matter of the complaint. ***Its interest is joint with theirs.***

Id. at 284 (emphasis added). *See generally Int'l Fed'n of Prof. & Technical Eng'rs v. City & County of San Francisco*, 79 Cal. App. 4th 1300, 1308 n.9 (2000) ("MEA clearly had standing to involve itself on its members' behalf in the legal proceedings").

In such cases, ***representational standing is the equivalent of class action representation***, and class action procedure, including notice to individual class members, is superfluous. *See Glendale City Employees' Ass'n v. City of Glendale*, 15 Cal. 3d 328, 341 (1975) (in case under Meyers-Milias-Brown Act ("MMBA"), because plaintiff association could sue in its own name on behalf of members, class action format added nothing to rights or liabilities of parties, and "***the issue of notice to the members of the class is immaterial***") (emphasis added).

Nor does it matter that the subject of the litigation is the union members' claim to benefits or other entitlements of employment governed by the MMBA. *See generally* Cal. Gov't

Code § 3504 ("the scope of [the unions'] representation shall include all matters related to employment conditions and employer-employee relations, including but not limited to wages, hours, and other terms and conditions of employment . . . ."). In *California School Employees Association v. Willits Unified School District*, 243 Cal. App. 2d 776, 780 (1966), the union's standing to sue on behalf of its members under the MMBA was challenged on the grounds that individual actions by the members were required because the individuals' interests were personal, and the evidence relating to the individuals' salary and damages would vary. Citing the public interest in the resolution of important statutory issues, the court rejected the contention that the union was an insufficient representative of the individual interests of its members in their perquisites of employment:

> [A]n organization which qualifies under [the MMBA has] standing to sue in its own name to enforce the employment rights of its members . . . . [T]he question [presented] is not only of common interest. . . , but it is of public interest, for the issues relate to interpretation of important statutes . . . [¶] Equally lacking in substance is the district's contention that individual actions should have been brought because the evidence relating to [the members] was different. It was different as to amounts of salary and perhaps other details, but not as to substantial issues, particularly when interpretation of the same statutes was essential to both cases.

Id. Having found jurisdiction to adjudicate the dispute with the union as the sole plaintiff, the court then proceeded to determine that the "award of back salary to one employee and damages for diminished income to the other cannot be sustained," *id.* at 787, making clear that jurisdiction lay to rule adversely to the employee union members in an action brought on their behalf by the union itself.

Particularly where, as discussed below, the remedy contemplated by the law is declaratory relief and mandamus, which will entail further legislative, judicial and administrative proceedings upon remand, the individual union members need not be joined. *See Bhd. of Teamsters & Auto Truck Drivers v. Unemployment Ins. Appeals Bd.*, 190 Cal. App. 3d 1515 (1987). In that case, the court followed the United States Supreme Court opinion in *Brock*, and held that the union had standing to litigate whether its employees were eligible for benefits, and that the employees need not be joined as parties to the lawsuit. *Id.* at 1521-24. Noting that state

law on standing is "consistent with federal law," *id.* at 1521 n.3, the court wrote:

> Here, as in *Brock*, the mandate proceeding raises a pure question of law, i.e. whether the Board properly interpreted section 1262 in denying its benefits to the union member claimants. Although the Board may have to determine each claimant's benefits, the unions may litigate this case ***without the participation of its members*** and still insure that the remedy, if granted, will inure to the benefit of those union members who have been injured.

Id. at 1523 (emphasis added). *See generally* 8 B. Witkin, Cal. Proc. 4th Writs § 77 (1997) (participation of individual union members not necessary for issuance of writ of mandamus).

Asserting their desire for representational standing, the Unions moved to intervene in this case, specifically alleging that they represent the interests of their individual members. *See* San Diego City Firefighters, Local 145, Complaint in Intervention, dated August 2, 2005, Ex. 2188.2-3 (¶ 3) ("Local 145 is the certified bargaining representative for all employees of the City of San Diego in the Fire Fighter Unit . . . . Local 145 has a fundamental interest in preserving the City Retirement Benefits being challenged by Aguirre because it represents employees who have worked and are working for the City with the expectation of receiving those benefits . . . . Local 145 represents both safety members and general members of SDCERS whose vested retirement benefits have been challenged by Aguirre and are at issue in the Action"); AFSCME Local 127's Complaint in Intervention, filed August 10, 2005, Ex. 2189.2-3 (¶ 3a) (Local 127 is the exclusive bargaining representative for approximately 2200 active employees. . . . In its statutory capacity under the Meyer-Milias-Brown Act . . . Local 127 has the exclusive right and duty to represent all employees in the Unit regarding matters within the scope of representation, including retirement benefits"); Declaration of Ronald L. Saathoff in Support of Firefighters, Local 145, Ex Parte Application to Intervene, at 8 (¶¶ 7, 9) (Local 145 "represents the employees who have worked for the City with the expectation of receiving those benefits. If Aguirre is successful, members of Local 145 will be deprived of retirement benefits . . . . [¶] Local 145 is the only entity authorized by law to represent the employment interests of firefighters"); San Diego Municipal Employees' Association's Complaint in Intervention, filed August 10, 2005, Ex. 2190 at ¶ 1 ("MEA is a recognized employee organization within the meaning of the state's [MMBA]. Acting in this statutory capacity, MEA has negotiated a series of labor agreements, known as

'Memoranda of Understanding' (MOUs), with the City of San Diego on behalf of approximately 6,000 City employees . . . for whom MEA is the exclusive bargaining representative. These MOUs embody the results of MEA's good faith bargaining on all matters within the scope of representation as defined by law, including pension benefits.").

The Unions' Complaints specifically seek a determination that the benefits awarded under MP I and MP II are lawful under conflict of interest law. *See, e.g.,* San Diego City Firefighters, Local 145, Complaint in Intervention, dated August 2, 2005, Ex. 2188.3 (¶ 6) ("The Contested Retirement Benefits were not enacted in violation of Government Code section 1090 or the Political Reform Act, Government Code sections 81000 et seq."); *see also Ex Parte* Application by San Diego City Firefighters, Local 145, for Leave to Intervene, dated August 2, 2005, at 2 ("Local 145 has a fundamental interest in preserving the City Retirement Benefits being challenged by Aguirre because it represents the employees . . . . If Aguirre is successful, members of Local 145 will be deprived of retirement benefits . . . ."); AFSCME Local 127's Complaint in Intervention, filed August 10, 2005, Ex. 2189.4 (prayer for relief that the Contested Benefits are "lawful and enforceable in all respects").

The Court granted the motions to intervene, and the Unions (as well as the Abdelnour Plaintiffs) have been full participants and vigorous advocates for their members' interests in establishing the legality of the benefits, advocacy of which the beneficiaries are well aware. For example, Firefighter John Thompson testified in response to the question of whether the 1300 individual members of the Firefighters Union are in "some way a party to this case," that "I guess we all are as far as benefits." Tr. Oct. 31, 2006 a.m. at 71:8-13. Thompson also testified that counsel for the Firefighters was protecting his interest in this litigation:

> Q. You have an interest in the outcome of this case today, do you not?
>
> A. Yes, sir.
>
> Q. Who is representing your interests in that?
>
> A. Mr. Klevens.
>
> Q. Okay. And it's your understanding that he's looking out for the overall interest of the Firefighters in this case.

A. Yes . . . .

Tr. Oct. 31, 2006 p.m. at 30:4-12.

Similarly, former MEA President Judith Italiano testified that the MEA members "are relying on us protecting the language that we fought for, that talks about their retirement benefits." Tr. Nov. 7, 2006 p.m. at 15:19-28. The MEA has told its members about the basic nature of the litigation, *id.* at 11:26-28; how the case is proceeding before the Court, *id.* at 12:1-5; that "our attorney is representing the organization's agreement with the City about our retirement," *id.* at 12:22-27; and that the Union is looking out for their interest in this litigation, *id.* at 12:28-13:9.[8]

With their participation now guaranteed, the Unions and their members cannot have it both ways—claiming standing to establish the ***validity*** of their employees' benefits under MP I and MP II, but not the converse—to suffer a determination of the legal ***invalidity*** of such benefits under state conflict of interest or debt limit laws. Rather, not only do the Unions have the standing to litigate on behalf of their employee members without joining such members in the lawsuit, but adverse as well as favorable decisions may obtain from such litigation. *See, e.g., San Bernardino Public Employees Ass'n v. City of Fontana*, 67 Cal. App. 4th 1215, 1223 (1998) (in litigation brought by union relating to employee benefits brought under MMBA, courts adjudicated rights of employees; appellate court held that trial court erred in holding that employees' rights in certain benefits were vested because public employees have no vested right in any particular measure of benefits); *accord In re Retirement Cases*, 110 Cal. App. 4th 426, 469-72 (2003) (in consolidated action in which numerous cases had union as sole plaintiff, court determined that retirement boards had discretion to collect arrearages in contributions from plan members to fund contribution shortfall arising from board's mistaken interpretation of law); *Cal.*

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[8] *See* Tr. Nov. 7, 2006 p.m. at 12:28-13:4 (Testimony of Judith Italiano, former President of the MEA) ("Q. Have you told the [union] members that . . . the union is looking out after their interest in this litigation? A. As it relates to what we have bargained in our MOU, yes."). *See also* Declaration of Edward G. Lehman In Support of AFSCME's Ex Parte Application for Leave to Intervene, dated August 1, 2005, at 3 (¶ 4) ("The employees represented by Local 127 are acutely aware of the current controversy concerning the lawfulness of the current SDCERS benefit structure . . . .").

Sch. Employees Ass'n v. Sequoia Union High Sch. Dist., 272 Cal. App. 2d 98, 103-104, 112 (1969) (association had standing to sue in litigation regarding employees' rights; court ruled adversely to affected employees); *California School Employees Association v. Willits Unified School District*, 243 Cal. App. 2d at 780, 788.[9]

Indeed, the unions represent ***all*** the employees and beneficiaries. *See* R. Weil, *et al.*, *Cal. Practice Guide: Civil Procedure Before Trial* § 14:242 (The Rutter Group 2006) (for representative actions, labor unions are treated "specially"; they have "standing to sue on behalf of their members individually, and even on behalf of ***nonmembers***") (citing *Anaheim Elementary Educ., CTA/NA Ass'n v. Board of Educ./ Anaheim Sch. Dist.*, 179 Cal. App. 3d 1153, 1159 (1986)) (emphasis in original). As explained by the court in *Relyea v. Ventura County Fire Protection District*, 2 Cal. App. 4th 875, 882 (1992), a member of an employee bargaining unit is bound by the terms of a collective bargaining agreement, ***even though the member is not formally a party to the agreement, and may not even belong to the union which negotiated it.*** *Id.* ("It also is a fundamental principle that a member of an employee bargaining unit is bound by the terms of a valid collective bargaining agreement, though he is not formally a party to it and may not even belong to the union which negotiated it.") (citing *San Lorenzo Educ. Ass'n v.*

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[9] *Silver v. Los Angeles Co. Metropolitan Transportation Authority*, 79 Cal. App. 4th 338 (2000), cited by Intervenors, does not overcome the rules on representational standing, a doctrine *Silver* did not consider. *Silver* merely held that the trial court did not abuse its discretion in weighing several considerations (not present here) and concluding that employees were indispensable parties. *Id.* at 349-50. Because the decision as to whether a party qualifies as indispensable is a matter where the trial court has a large measure of discretion, *e.g., Kaczorowski v. Mendocino County Bd. of Supervisors*, 88 Cal. App. 4th 564, 568 (2001), the affirmance of the exercise of such discretion on a particular set of facts does not establish a rule of law contravening the many authorities above. The facts in *Silver* were completely different from the facts here—in *Silver*, the ***unions*** (petitioners) sought to recoup individual payments made by defendant/respondent governmental agency to certain employees from whom the governmental agency would have to recoup the payments if relief were granted. *Id.* at 346, 348. Here, as discussed below, the City seeks a declaration as to the invalidity of administrative and legislative actions, and a remand to the legislative body for corrective proceedings—not a remedy against any individual employee or retiree for a return of monies paid. In contrast to *Silver*, where the failure to join additional parties threatened a multiplicity of proceedings and inconsistent judgments, here a resolution by the Court will reduce litigation by providing needed certainty as to respective rights under the law in the face of multiple federal and state court cases involving the same issues, and a productive remedy by way of remand to the authorized decision-making body. *See infra* Section V.

Wilson, 32 Cal.3d 841, 846 (1982)). All employees are bound by the terms of the agreement, which, if unlawful, is invalid as to all of them. *Id.*

b. As Trustee, SDCERS Represents the Absent Parties

The absent parties are also well represented by the pension system trustee, SDCERS, which has a statutory fiduciary duty to protect the beneficiaries' interests. Cal. Const., Art. XVI, § 17. When the beneficiaries' interests are adequately represented by the trustee, the beneficiaries are not necessary parties. *Hebbard v. Colgrove*, 28 Cal. App. 3d 1017, 1027 (1972). As the court explained in *Bowles v. Superior Court*, 44 Cal. 2d 574 (1955), a trustee is a proper representative of the trust beneficiaries when "[t]he same facts and legal principles will determine the [outcome] regardless of the individual desires or preferences of the beneficiaries." *Id.* at 588.

This is just such a case: The presence of city employees and retirees in this action would have no effect upon the Court's determination regarding the legal validity of the benefit increases created through MP I and MP II. *See Johnson v. Curley*, 83 Cal. App. 627, 631-33 (1927) (trustee adequately represents the interests of the trust beneficiaries in an action in opposition to the trust, as to set aside the trust instrument or to have the trust declared a nullity or void); *Watkins v. Bryant*, 91 Cal. 492, 504 (1891); *see also De Mota v. Super. Ct.*, 130 Cal. App. 2d 58, 63 (1955) ("It is true our courts have held that an action to set aside a deed of trust may be maintained against a trustee alone and a determination as to the validity of the trust instrument will be binding on the beneficiary even though not a party to the action."). *Cf. Copely v. Copely*, 126 Cal. App. 3d 248, 298 (1981) (beneficiaries are not indispensable parties to an action against trustees for breach of their fiduciary duties).

Accordingly, not only are the beneficiaries fully represented by the Unions, but they are also represented by the trustee of their pension fund, SDCERS. *See* SDCERS Verified Complaint for Declaratory Relief (filed January 27, 2005) ¶¶ 19-20 ("Pursuant to California Constitution, Article XVI, section 17, the Board is vested with the sole and exclusive fiduciary responsibility over the assets of the Retirement System" and "to administer the Retirement System in a manner that will assure prompt delivery of benefits and related services to the

participants and their beneficiaries"); *id.* ¶ 54 (alleging interests of City and SDCERS are in conflict as to matters "in which SDCERS' fiduciary duty to the Retirement System's participants and their beneficiaries pursuant to California Constitution, Article XVI, section 17(b), take precedence over any duties it may have to the City, including the duty to minimize employer contributions"); *see also* SDCERS Compulsory Cross-Complaint (dated March 24, 2006) ¶¶ 10-11 (same).

c. The Abdelnour Parties Also Represent the Absent Parties

Finally, the beneficiaries are also represented by the Abdelnour Plaintiffs, which consist of "194 individual City of San Diego retired employees, individual members of the City of San Diego unclassified service, former employees with a vested but deferred benefit, employees on an unapproved leave of absence, or individual existing City of San Diego employees unrepresented by a labor union . . . ." Abdelnour Plaintiffs' First Amended Complaint, Ex. 2187.2 (¶ 1). The participation of these individual parties ensures that the viewpoints of both non-union and retired employees are heard.

* * *

In sum, because complete relief (a declaration of invalidity of official action) can be afforded among those who are parties, because that declaration is in the public interest, and because the absent parties' interests are fully represented so that their interests will not be impaired or impeded, the Court finds that absent parties are not "necessary" within the meaning of Section 389(a). Even if such parties were technically necessary, however, the Court also finds that the action should proceed under Section 389(b), as discussed below.

B. In All Events, the Case Should Proceed Under Section 389(b)

The Court further determines that in equity and good conscience, the action should proceed. In view of the parties before the Court, as well as the identity of absent parties, a judgment rendered by the Court will be adequate. As detailed in the remedy discussion, *infra*, the Court can shape the relief provided in any judgment to avoid prejudice to absent parties and parties before the Court. It benefits all interested parties to obtain finality on the issues and the parties will not have an adequate remedy if the action is dismissed for nonjoinder. Judicial

efficiency will also be served by a resolution. Each of these points is supported by the findings and conclusions below.

1. Joinder of All System Beneficiaries is Impracticable and Unnecessary

Just as all taxpayers do not need to be before the Court, all interested employees need not be parties.[10] The impracticality of joining numerous parties—here, every employee, retiree, and beneficiary of the City retirement system—disfavors a determination that they are indispensable to the action. The "delay and expense" of joining so many (nearly 20,000) individuals is "oppressive and burdensome" and is therefore not required. *See Hebbard v. Colgrove*, 28 Cal. App. 3d at 1026-27; *see also Deltakeeper*, 94 Cal. App. 4th at 1106-1108 (in an action to set aside a contract, all parties to the contract are not indispensable parties; "the fact the action may affect the interests of the nonjoined parties in the underlying contract does not dictate the conclusion that they are indispensable parties"). In *Hebbard,* for instance, the court declined to require joinder of the beneficiaries in a trust fund suit "where the beneficiaries are very numerous, so that the delay and expense of bringing them in becomes oppressive and burdensome." 28 Cal. App. 3d at 1027; *see also People ex rel. Lungren*, 56 Cal. App. 4th at 882 (same). While the class action device theoretically is available, as noted, such procedure is superfluous as to employees and beneficiaries when the unions are parties, *Glendale Employees' Ass'n v. City of Glendale*, 15 Cal. 3d at 341, and particularly because the absent parties' interests are well represented, the Court declines to require participation of each and every potentially interested and already represented individual in the context of this public interest litigation. *People ex rel. Lungren*, 56 Cal. App. 4th at 882.

2. Equity Favors Resolution of This Case

Considerations of equity also favor resolving the legality of benefits issue in this lawsuit. *See Bank of Cal. v. Super. Ct.*, 16 Cal. 2d at 521. From the City's perspective, numerous public officials—including the Mayor—have urged the importance of obtaining a final judicial determination regarding the legal issues raised by MP I and MP II. Mayor Jerry Sanders has

[10] For example, it is impossible for ***future*** employees to appear in this case.

submitted a declaration to the Court stating that the lingering "cloud" of uncertainty in the City's finances created by the issues related to the pension system has limited the City's ability to obtain financing necessary to fund important public works projects, and to attract and retain talented public employees responsible for providing crucial City services. Declaration of Mayor Jerry Sanders, June 12, 2006, at ¶ 2. Among the most important of these issues, and "a major impediment" to the Mayor's stated objectives, is the "continuing uncertainty as to the legality of certain benefit increases created under . . . [MP I and MP II] . . . ." *Id.* at ¶ 3. The Mayor stated:

> 5. . . . I make this declaration to inform the Court, ***as the City's highest elected official, its chief executive officer, and as the head of City government, that the City needs and desires from this Court a determination as to the legality of the benefit increases under MP I [and] MP II*** . . . . The certainty provided by this Court's judicial determination will allow the City to move forward to ensure adequate funding to SDCERS based on the total amount of legal and valid benefits. Until that determination is made, it is enormously difficult for the City to quantify its present and future obligations and to match the City's revenue stream with its liabilities. As the leader of the City, and on behalf of the people of the City, I therefore respectfully ask this Court to . . . resolve the issues . . . .

Sanders Decl., at ¶ 5 (emphasis added).

Council President Scott Peters has also declared that a determination regarding the legality of the benefit increases under MP I and MP II, "will assist the City in quantifying its obligations and providing for adequate funding for the pension system." Declaration of City Council President Scott Peters, June 12, 2006, at ¶¶ 2-3. Council President Peters stated:

> I make this declaration to inform the Court that ***the City needs and desires from this Court an immediate and final determination as to the legality of the benefit increases under Manager's Proposals I and II*** . . . .

Id., at ¶ 3 (emphasis added).

The other parties, too, have committed enormous resources to this lawsuit, and need and desire certainty, as evidenced by the allegations of their pleadings in this case, asserting that the dispute is justiciable, and seeking declaratory relief on the benefit legality issue. *See, e.g., Ex Parte* Application of MEA for Leave to Intervene, dated August 2, 2005, at 6:16-17 ("MEA has a duty to act expeditiously and by all available means to eliminate the enormous uncertainty and

anxiety that has been created by the actions and statements of City Attorney Michael J. Aguirre . . . ."); Abdelnour Plaintiffs' First Amended Complaint, filed on or about August 23, 2006, Ex. 2187.7 (¶ 18) ("a judicial determination of the legality of the Contested Benefits is necessary to resolve the present controversy"); *id.* at 2187.8 (¶ 24) ("A judicial determination is necessary and appropriate at this time so that the parties can ascertain their respective rights and duties").

Without a determination by this Court of the fundamental legal issue presented as to the validity of the benefit increases in light of state conflict of interest law, the City and the other parties will not obtain a resolution of their respective legal rights.

3. Judicial Efficiency Favors Resolution

Resolution is also in the interests of the judiciary and judicial efficiency. This Court has spent a disproportionate share of judicial time on this case, and proceedings in other courts—state and federal—may turn on the outcome of rulings in this case, which is by far the most advanced of the multiple civil pension cases. The absent parties primarily are members of the San Diego Police Department, who elected to file a parallel action in federal court. The judge in that case has indicated that the issues should be resolved in this state court action. *See San Diego Police Officers' Ass'n v. Aguirre, et al.*, Case No. 05CV1581-H (Transcript of Proceedings, Oct. 13, 2006) at 37-38 ("And on some of the issues, Superior Court Judge Barton will begin a trial . . . if the—some of the pension benefits were void and, if so, what, if anything, can be done about that. And since we are stating State Court cases the—I have full confidence that a Superior Court State Court judge would be able to read the applicable cases and law and State . . . Constitution in this matters just as well as this Court would."). Only with a final decision on the pivotal legality of benefits issue can progress be made towards a constructive resolution.

* * *

In sum, Section 398 is a discretionary rule, meant to provide equity to those parties who should be joined and who could be joined. The universe of pension beneficiaries need not be joined to this lawsuit, when they are well represented by multiple existing parties and they have

not sought to intervene. The absent parties consist of some members of the City work force not represented by a municipal union and some City retirees who have chosen not to intervene in this action (others are represented by the Abdelnour Plaintiffs). The Court has determined that it may and should proceed to provide relief among the parties before the Court in light of the protections that may be contained in any final judgment. Before the Court enters any final judgment, the Court will consider giving notice to any absent party if a factual showing is made that the absent party's interests will suffer undue and individual prejudice.

V.

THE FIFTH AMENDED CROSS-COMPLAINT PRESENTS AN ACTUAL, JUSTICIABLE CONTROVERSY ON WHICH THIS COURT CAN RENDER A MEANINGFUL, CONCRETE AND SPECIFIC DECREE

Phase III of this trial will address the pivotal issue of whether members of the SDCERS Board and City officials violated California Government Code Section 1090 and state conflict of interest laws by (1) developing and approving MP I and MP II, thereby increasing City employees' benefits (including their own), and (2) influencing the City to adopt these agreements and implement Union contracts and benefits legislation by various means, including permitting the underfunding of the pension system. For present purposes, the Court will assume that Section 1090 was violated, and will assess ***if*** that is so, whether there is a justiciable remedy under the circumstances.

A. Remedies Exist Under State Conflict of Interest Law

Government Code Section 1090 codifies one of the statutory prohibitions against public officials acting in their official capacity on matters in which they have a personal financial interest. Section 1090 provides that:

> [m]embers of the Legislature, state, county, district, judicial district and city officers or employees shall not be financially interested in any contract made by them in their official capacity, or by any body or board of which they are members.

Section 1090 requires that "every public officer be guided solely by the public interest, rather than by personal interest, when dealing with contracts in an official capacity." *Thomson v.*

Call, 38 Cal. 3d 633, 650 (1985). It is aimed at eliminating temptation, avoiding the appearance of impropriety and assuring the government of the officer's undivided and uncompromised allegiance. *Finnegan v. Schrader,* 91 Cal. App. 4th 572, 579-80 (2001). Government "officers and employees are expected to exercise absolute loyalty and undivided allegiance to the best interests of the governmental body or agency of which they are officers or employees, and upon the basis that the object of such a statute is to remove or limit the possibility of any personal influence, either directly or indirectly which may bear on an officer's or employee's decision." *Millbrae Ass'n for Residential Survival v. City of Millbrae*, 262 Cal. App. 2d 222, 237 (1968).

If a public official is pulled in one direction by his financial interest and in another direction by his official duties, his judgment cannot and should not be trusted, even if he attempts impartiality. *Carson Redev. Agency v. Padilla*, 140 Cal. App. 4th 1323, 1330 (2006). Properly understood, Section 1090 stands as a prophylactic against the temptations that might corrupt or influence public officials. *Id.*

When Section 1090 is transgressed, the public entity involved is entitled to recover any compensation that it paid under the unlawful contract without restoring any of the benefits it received: The contract is against the express prohibition of the law, and the courts will not entertain any rights growing out of such a contract, or permit a recovery upon quantum meruit or quantum valebat. *Id.* at 1331. As the *Carson* court elaborated:

> The rule of forfeiture is not an outmoded remedy blind to equity. It is, rather, a remedy that is utilitarian in its design; it recognizes what is equitable for the community and necessarily subordinates the individual in a given case. Ultimately, this policy serves all individuals because they comprise our communities and need every guarantee the law can provide that they will be free from the tyranny of corrupt politicians and the burden of contracts tainted by conflicts of interest.

Id.

In the context of this case, the public was entitled to have their governmental officials consider the proposed rate stabilization plan without those officials receiving more pension benefits if they were able to secure approval. The question to the SDCERS Board simply should have been whether to allow the City to pay less than the actuary said was needed, without the

corrupting corresponding consideration of personal financial gain. According to the City's claim, rather than divorcing their self interest from their actions, City officials who stood to gain pushed though MP I and MP II in the hope of increasing their personal pension benefits.

"The case law supports strict enforcement of conflict-of-interest statutes." *Thomson v. Call*, 38 Cal. 3d at 650. *See also Carson Redev. Agency v. Padilla*, 140 Cal. App. 4th at 1333, 1335 ("The sweep of section 1090 is broad; within its reach comes any interest that might deter a public official from the most righteous and noble path of civil service possible"; to construe the statute narrowly "would undermine the public's confidence not only in the government, but in the court system ruling on such cases. An important, prophylactic statute such as section 1090 should be construed broadly to close loopholes; it should not be constricted and enfeebled"); *Thorpe v. Long Beach Cmty. Coll. Dist.*, 83 Cal. App. 4th 655, 663 (2000) (statutes prohibiting conflicts of interest are "'strictly enforced'").

Consistent with this strict enforcement, the Government Code expressly provides that every contract made in violation of Section 1090 is ***void***. Cal. Gov't Code § 1092; *see also Marin Healthcare Dist. v. Sutter*, 103 Cal. App. 4th 861, 877 (2002) (a contract in which a public officer is interested is void, not merely voidable); *Stigall v. City of Taft*, 58 Cal. 2d 565, 571 (1962). Thus, if any interest compromises a public official's fidelity such that he may be influenced by personal considerations, Government Code Section 1092 provides the mechanism to ameliorate the concomitant injury to society:

> Every contract made in violation of any of the provisions of Section 1090 may be avoided at the instance of any party except the officer interested therein. No such contract may be avoided because of the interest of an officer therein unless such contract is made in the official capacity of such officer, or by a board or body of which he is a member.

Cal. Gov't Code § 1092.

A leading treatise on municipal law expresses the same concepts:

> The public is entitled to have its representatives perform their duties free from any personal or pecuniary interest that might affect their judgment. Public policy forbids the sustaining of municipal action founded upon a vote of a council member . . . in any matter before it which directly or immediately affects him or

> her individually . . . . A finding of self-interest sufficient to set aside municipal action need not be based upon actual proof of dishonesty, but may be warranted whenever a public official, by reason of personal interest in a matter, is placed in a situation of temptation to serve his or her own purposes, to the prejudice of those for whom the law authorizes the official to act . . . . [A]n individual member ordinarily cannot vote on a matter in which that member . . . is interested. If the member does, the action taken by the body of which he or she is a member is invalidated . . . . ***Where the vote of a member interested is necessary to pass an ordinance or bylaw, such ordinance or bylaw is void, irrespective of how beneficial the ordinance may be.***

4 McQuillin, Law of Municipal Corporations, § 13.35 at 898-901 (3d ed. 2002) (emphasis added) (citing *Clark v. City of Hermosa Beach*, 48 Cal. App. 4th 1152, 1171-72 (1996)).

Thus, under Section 1092, if, as the Court assumes for purposes of analysis of the remedy, the Board members' and City officials' creation, approval and implementation of agreements and legislation—which resulted in increasing their own benefits, while underfunding the system they were duty-bound to protect—violated Section 1090 and state conflict of interest law, the resulting agreements are not merely voidable, but void *ab initio* and they must be set aside. *See Finnegan,* 91 Cal. App. 4th at 583-84 (invalidating contract and citing Section 1092 for proposition that contracts made in violation of Section 1090 are void); *Stigall,* 58 Cal. 2d at 571 (invalidating pursuant to Section 1092 a contract between the city and a plumbing company that was owned in part by a city councilman); *Millbrae Ass'n for Residential Survival*, 262 Cal. App. 2d at 236 (explaining that "[a] contract or transaction entered into in violation of [Section 1090] is invalid," and citing Section 1092 in reversing and remanding a decision holding that a contract was valid despite violation of Section 1090); *In re Barlow*, 67 Ops. Cal. Atty. Gen. 369 (1984), 1984 WL 162079, *5 ("Contracts made in violation of section 1090, though described as voidable in section 1092, are in fact void."); *see also Thomson*, 38 Cal. 3d at 646 & n.15 (collecting cases and stating that "California courts have generally held that a contract in which a public officer is interested is void, not merely voidable."); *Terry v. Bender*, 143 Cal. App. 2d 198, 206 (1956) (the rationale behind Section 1090 is that "[a] transaction in which the prohibited interest of a public officer appears is held void both as repugnant to the public policy

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expressed in the statutes and because the interest of the officer interferes with the unfettered discharge of his duty to the public.").[11]

If an official is a member of a board that actually executes or approves the contract, he or she is conclusively presumed to be involved in the making of his or her agency's contract. *Thomson*, 38 Cal. 3d at 645, 649. The mere presence of one board member with a financial interest in a transaction is sufficient to invalidate that transaction, even if the member has not voted on the matter or participated in discussions leading up to the vote. *Finnegan v. Schrader*, 91 Cal. App. 4th at 581-82. Forbidden interests extend to the expectations of benefit by express or implied agreement that may be inferred from the circumstances. *People v. Gnass*, 101 Cal. App. 4th 1271, 1298-99 (2002); *see also People v. Darby*, 114 Cal. App. 2d 412, 431 (1952) (prohibited interest may be benefits which arise after the taking of governmental action). The prohibitions of Section 1090 also reach "preliminary discussions, negotiations, compromises, reasoning, planning, drawing of plans and specifications and solicitation for bids." *Millbrae Ass'n for Residential Survival*, 262 Cal. App. 2d at 237.

There are numerous cases invalidating contracts involving interested government officials in circumstances akin to those alleged here. *See, e.g., City Council of the City of San Diego v. McKinley*, 80 Cal. App. 3d 204, 213 (1978) (affirming refusal to enforce contract as invalid under Section 1090; contract between landscape firm and City Park and Recreation Board invalid where board member was president and stockholder of landscape firm: "The law of this state is that public officers [which include board members] shall not have a personal interest in any contract made in their official capacity . . . . [T]he object . . . is to remove or limit the possibility of any personal influence either directly or indirectly which might bear on an official's decision as well as to void contracts which are actually obtained through fraud or dishonest conduct. Statutes prohibiting such 'conflicts of interest' by a public officer are strictly

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[11] In its pleadings in this case, SDCERS has admitted this result is required. *See* SDCERS Compulsory Cross-Complaint (dated March 24, 2006) ¶ 45 ("Pursuant to Government Code section 1092, in the event the Court finds that MP I and MP II were made in violation of Government Code section 1090, MP I and MP II were void from inception").

enforced. These propositions are supported by a plethora of authority most notably Government Code sections 1090-1092 . . . .") (citation omitted). *See also President & Trustees of City of San Diego v. SD & LA R.R. Co.*, 44 Cal. 106, 113 (1872) (setting aside a deed of public land to railroad where one of public officials executing deed on behalf of City (Sherman) owned stock in railroad at time of deed; "The general principle is, that no man can faithfully serve two masters, whose interests are or may be in conflict. The law, therefore, will not permit one who acts in a fiduciary capacity to deal with himself in his individual capacity") (cited in *Thomson v. Call*, 38 Cal. 3d at 648); *Imperial Beach v. Bailey*, 103 Cal. App. 3d 191 (1980).

SDCERS Board members and City officials participated in the making of the MP I and MP II benefit agreements and in carrying out the related legislative acts. They so acted while holding personal and direct financial interests in both MP I and MP II. Those agreements increased these public officials' personal retirement benefits. Accordingly, the City alleges that Section 1090 prohibited the participation of the SDCERS Board members and City officials in making the Manager's Proposals, and because they did participate, Section 1092 and other state conflict of interest laws render those agreements void.

This alleged conduct—public board members and City officials voting themselves benefit increases—is precisely what Section 1090 and other state conflict of interest law forbid. *See Finnegan v. Schrader*, 91 Cal. App. 4th at 584 (affirming finding that Section 1090 voided the appointment by a board of one of its own members as district manager of a sanitary district, even though he did not personally vote); *Campagna v. City of Sanger*, 42 Cal. App. 4th 533, 538-39, 541-42 (1996); *Downey Cares v. Downey Cmty. Dev. Comm'n*, 196 Cal. App. 3d 983, 988-91 (1987) (invalidating a city action (an ordinance) because it was reasonably foreseeable that the ordinance could have a material effect on a council member's financial interest; "[t]he test is whether it was reasonably foreseeable that the adoption of the plan would have a material financial effect on [the member's] property and business . . . ."); *Witt v. Morrow*, 70 Cal. App. 3d 817, 822 (1977) (councilman acting as member of redevelopment agency disqualified from participating in decisions on development plan where it could have an effect on nonprofit corporation of which official was officer); *People v. Sobel*, 40 Cal. App. 3d 1046, 1053 (1974)

(Section 1090 prohibited a city employee from awarding contracts to a corporation in which he and his wife were the significant shareholders); *People v. Elliott*, 115 Cal. App. 2d 410, 416 (1953) (holding that Board of Education could not award school district's transportation contract to company that was represented by attorney who was also a member of the board); *see also Stigall v. City of Taft*, 58 Cal. 2d at 571 (voiding a contract between the city and a plumbing company that was owned in part by a city councilman); *accord* 77 Ops. Cal. Atty. Gen. 112 (1994) (stating that contract to design new airport could not be awarded to architectural firm when one of its members also sat on the city arts commission that had to approve design).

B. Legislative Ratification or Estoppel Could Not Cure the Violation

The Unions assert that this Court is powerless to impose a remedy—assuming a violation is found—because the City Council effectively ratified MP I and MP II through implementing legislation and subsequent MOUs. While this argument anticipates issues that will be tried in Phase III (for example, the City's contention that the SDCERS Board members used the underfunding concession and otherwise participated in improperly influencing the City to increase benefits, and thereby tainted the legislative process, as well), assuming a violation, the Court could not uphold MP I and MP II benefit increases on a ratification theory in any event.

Rather, as a matter of law, the City Council could not cure the conflict of interest defects in MP I and MP II merely by approving or ratifying the earlier action; because of the illegality arising from the conflicts of interest, those actions are void *ab initio* and, accordingly, could not be ratified or serve as a basis for estoppel. *See Berka v. Woodward*, 125 Cal. 119, 129 (1899) (the fact that claim was allowed by the council did not give it validity that it did not otherwise possess; contract based on conflict of interest was void); *Schaefer v. Berinstein*, 140 Cal. App. 2d 278, 289-93 (1956) (upon violation of Section 1090, city council had duty to declare resulting action void); *see also City Lincoln-Mercury Co. v. Lindsey*, 52 Cal. 2d 267, 274 (1959) ("A party to an illegal contract cannot ratify it, cannot be estopped from relying on the illegality, and cannot waive his right to urge that defense"); *Fewell & Dawes, Inc. v. Pratt*, 17 Cal. 2d 85, 91 (1941) ("An illegal contract cannot be ratified, and no person can be estopped from denying its validity"); *Downey Venture v. LMI Ins. Co.*, 66 Cal. App. 4th 478, 511 (1998) ("An illegal

contract is void; it cannot be ratified by any subsequent act, 'and no person can be estopped to deny its validity.' It is clear that estoppel cannot be relied upon to defeat the operation of a policy protecting the public.") (citation omitted); *see generally* 1 Witkin, Summary of California Law, Contracts § 432 (2006) ("Because an illegal contract is void, it cannot be ratified by any subsequent act and no person can be estopped to deny its validity").[12]

The presence of third party beneficiaries, even innocent ones, cannot avoid this result. It is hornbook law that "[a] third person for whose benefit an illegal contract is made does not, as a rule, acquire any rights thereby." 17A C.J.S. Contracts § 286 (2005).

> The general rule is that if the express contract is one the municipality had no power to make, i.e., ultra vires in the strict sense of the term, or if the municipality could not make an express contract of the kind sought to be enforced, the municipality cannot be held liable . . . for the value of benefits received. A municipality is not required to compensate for benefits received under a void contract, where to do so would be tantamount to annulling a statute, or doing by indirection that which the municipality is not permitted to do directly. ***These rules are designed to protect the municipal taxpayers*** . . . .

10A McQuillin on Municipal Corps., § 29.111.10 (emphasis added). *See also Miller v. City of Martinez*, 28 Cal. App. 2d 364, 370-72 (1938) (city could recover price of goods received under contract void for conflict of interest without returning goods; because the contract was void as against public policy, "there is no ground for any equitable considerations, presumptions or estoppels"); *accord G.L. Mezzetta, Inc. v. City of American Canyon*, 78 Cal. App. 4th 1087, 1094

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[12] *See also* 17A Am. Jur. 2d Contracts § 308 (2006) ("A contract that is void as against public policy or statute cannot be made valid by ratification"); 10A McQuillin on Municipal Corporations § 29.104.30 ("Contracts which a municipal corporation is not permitted legally to enter into are not subject to ratification"; no ratification of contract that is contrary to declared public policy); 64 C.J.S. Municipal Corporations § 914 ("A municipal contract which is void in its inception is not validated by performance but remains a void contract.") Indeed, the municipality may avoid performance even though other party has performed: "Where the municipality fails to comply with a statute, and the purpose of the statute is to protect taxpayers rather than the municipality, equity may not be invoked to enforce an agreement against the municipality. . . . [M]unicipal contracts involving in their execution or enforcement a violation of public policy are void." *Id.*; *see also id.* at § 915 (an ultra vires or illegal contract is not susceptible of validation). The only way for the prior actions to be ratified, is for the Court to remand to the City Council for new proceedings free of the invalidating conflict, as discussed, *infra*.

(2000) (estoppel may not be invoked to enforce a void contract); *County of Shasta v. Moody*, 90 Cal. App. 519, 523-24 (1928) (the "contracts being void under the express provisions of the statute, and also being against public policy, there is no ground for any equitable considerations, presumptions or estoppels").

The recent case of *Carson Redevelopment Agency v. Padilla*, 140 Cal. App. 4th 1323 (2006), makes clear that conflicts of interest invalidate the resulting action, even when the result harms innocent third parties. The court held that disgorgement of amounts paid by the city to owners of a senior housing complex under a contract tainted by conflict of interest was an automatic remedy; even though the owners were victims themselves, their interest must yield to the "greater interest" of the public in avoiding the effects of corruption and its effects on the public fisc. *Id.* at 1336-37. As the court wrote in *Carson*:

> If any interest compromises a public official's fidelity such that he may be influenced by personal considerations rather than the public good, then there must be a mechanism to ameliorate the concomitant injury to society. Section 1092 is that mechanism. It would lose much of its sting if it were not permissible to unravel the machinations of criminal minds and trace their paths of deceit to pinpoint indirect financial interests that might influence public officials.

Id. at 1334 (citation omitted).

Thus, as *Carson* notes, when "section 1090 is transgressed the public entity involved is entitled to recover any compensation that it paid under the contract without restoring any of the benefits it received." *Id.* at 1331. The disgorgement of benefits received under a void contract is automatic:

> *Thomson* gave its imprimatur to a long line of cases applying that remedy, and it approved that remedy against Call. *Thomson* considered a flexible rule, but then decided against it for policy reasons after considering the unacceptable ramifications of such a rule. More recently, *Finnegan* held that a public entity is entitled to recover any compensation it paid under a tainted contract without restoring any of the benefits it received. By logical import, *Finnegan* interpreted *Thomson* as a binding precedent holding that the disgorgement remedy is automatic. For policy reasons, we follow the lead of *Finnegan*. We do so for two reasons. Based on stare decisis, we pay deference to the long history of consistent appellate case law recognized in *Thomson*.

> Also, as a policy matter, it is the most effective way to give section 1090 all the teeth that it needs.

Id. at 1334-36 (citations omitted).

Likewise, in a United States Supreme Court case strikingly similar to this one, trustees of union health and retirement funds sued a coal producer (Kaiser) for contributions due under a collective bargaining agreement. *Kaiser Steel Corp. v. Mullins*, 455 U.S. 72, 74-76 (1982). Kaiser claimed that it did not owe the contributions because the collective bargaining agreement giving rise to them was illegal. *Id.* at 76. The Supreme Court agreed that Kaiser was entitled to claim the contract was illegal, and explained that ordering Kaiser to make the contributions would be tantamount to enforcing an illegal agreement, something the Court refused to do. *Id.* at 77-82. Significantly, the Court refused to enforce the illegal agreement ***even when doing so reduced the health and retirement funds of the union members***. *Id.* at 83 & n.8 (explaining that "***pension fund trustees have no special status which exempts them from the general rule that courts do not enforce illegal contracts***"); *see also Carpenters Amended & Restated Health Benefit Fund v. Cope & Smith*, 544 F. Supp. 442, 450 (N.D. Tex. 1982) (court refused to require employer to contribute to pension funds when the contributions inherently were linked to an illegal agreement).

Like the owners in *Carson* and the trustees in *Kaiser*, the Unions seek enforcement of benefits for third parties that arise out of alleged illegal contracts. As in those cases, the fact that the contracts benefit third parties provides no support for enforcing an illegal agreement. *Kaiser*, 455 U.S. at 83 & n.8; *Carson Redev. Agency v. Padilla*, 140 Cal. App. 4th at 1334-37; *see also Carpenters Amended*, 544 F. Supp. at 450. Simply put, courts do not enforce illegal contracts, no matter who the beneficiaries may be. *See Miller v. McKinnon*, 20 Cal. 2d 83, 89 (1942) (person who has supplied labor and materials in performance of illegal contract has no right to recover thereunder); *Amelco Electric v. City of Thousand Oaks,* 27 Cal. 4th 228, 234 (2002) (same); *see also Finnegan v. Schrader*, 91 Cal. App. 4th at 584 ("Various provisions of the Labor Code do evince a strong public policy of ensuring employees are paid fully and promptly for their efforts. We do not believe that these provisions were intended to ratify illegal

employment contracts or to immunize a public official from liability for a conflict of interest. The disgorgement remedy adopted by the trial court was appropriate.") (citation omitted); *Campagna v. City of Sanger*, 42 Cal. App. 4th at 542 (city attorney who negotiated referral agreement in which he stood to benefit forfeited right to funds); *Millbrae Ass'n for Residential Survival*, 262 Cal. App. 2d at 237-38 (fact that public contract had been substantially performed would not preclude contracts from being invalid due to conflict of interest).

Intervenors argue that the Court cannot take away rights that have "vested" in them as a result of MP I and MP II. That argument ignores, however, the preliminary question of whether the rights have "vested." "The words [vested rights] are generally used as implying interests which it is ***proper*** for the state to recognize and protect, and of which the individual cannot be deprived arbitrarily without injustice." *American States W.S. Co. v. Johnson*, 31 Cal. App. 2d 606, 614 (1939). As evidence from *Thomson* and *Carson*, *supra*, contracts entered into in violation of Section 1090 are void and not enforceable. Therefore, Intervenors' argument that their "rights" have "vested" merely begs the question of whether there was a Section 1090 violation, and it would not be proper for this Court to "recognize and protect" the enhanced benefits awarded under MP I and MP II if they did not vest in the first instance because the agreements were void.

Thus, if the benefit contracts were illegally adopted, no pension benefits could vest under them. *Kaiser*, 455 U.S. at 83 & n.8. Courts frequently have set aside beneficiaries' claims to pension benefits when such claims rest on an illegal agreement. *See Romano v. Retirement Bd. of the Employees' Retirement Sys. of the State*, 767 A.2d 35, 38-39 & n.3, 46-47 (R.I. 2001) (pension benefits that arose based on ultra vires actions, and which were in conflict with state law could not be enforced—even when beneficiary allegedly "'committed no evil' when he feathered his retirement nest with over $100,000 in illegal public retirement benefits"); *Strong v. State of Oklahoma ex rel. Oklahoma Police Pension & Retirement Bd.*, 115 P.3d 889, 894-95 & n.23 (Okla. 2005) (retirement system could not be estopped from denying illegal benefits) (citing numerous cases); *Fraternal Order of Police, Lodge No. 2 v. County of Douglas*, 612 N.W.2d 483, 488 (Neb. 2000) (affirming summary judgment that pension plan benefits reduction was

null and void under governing law requiring voter approval); *Plainfield Township Policemen's Assoc. v. Penn. Labor Relations Bd.*, 695 A.2d 984, 985 (Pa. Comm. Ct. 1997) (affirming Labor Relations Board's refusal to enforce pre-existing pension benefits that were illegal under law and should never have been agreed to in collective bargaining agreement). *See also Retirement Bd. of Allegheny Co. v. Colville*, 852 A.2d 445, 451-52 (Pa. Comm. Ct. 2004) (refusing to remand to enforce illegal retirement benefits); *Borough of Ellwood City v. Ellwood City Police Dep't Wage & Policy Unit*, 805 A.2d 649, 651 (Pa. Comm. Ct. 2002) (refusing to enforce illegal pension benefits); *Bd. of Control of the Employees' Retirement Sys. of Alabama v. Hadden*, 854 So. 2d 1165, 1169 (Ala. Ct. Civ. App. 2002) (employees' retirement system could not be estopped from suspending illegal retirement benefits); *accord City of Wilkes-Barre v. City of Wilkes-Barre Police Benevolent Ass'n*, 814 A.2d 285, 288-89 (Pa. Comm. Ct. 2002) (unlawful retirement benefits unenforceable where statute provides for unenforceability of excessive benefits); *cf. Parella v. Retirement Bd.*, 173 F.3d 46 (1st Cir. 1999) (legislators had neither contract nor property rights to pension benefits that exceeded amount permitted by law).

It should also be observed with respect to the beneficiaries' alleged rights that it was MP I and MP II ***themselves*** which impaired the contract rights of plan participants whose benefits had been paid for when those agreements were created. Under MP I and MP II, new benefits claims on the pension plan funds were established without the corresponding funding, to the detriment of the entire system, as shown by the trial evidence. The City's actuarial expert, Joseph Esuchanko, testified that under MP I and MP II, SDCERS "unfunded actuarial accrued liability had grown from $46.8 million prior to Manager's Proposal I, to $1.157 billion. It further grew to a deficit of $1.394 billion at June 30, 2005." Tr. Nov. 14, 2006 p.m. at 29:19-27. The funding level of the pension plan dropped under MP I and MP II from 97.1% to 67.2%. *Id.* at 30:3-8.

Specifically, Esuchanko testified that post-MP I and MP II, SDCERS has about $1.4 billion more in liabilities than it has in assets:

> Q. Okay. So what you were able to determine is that the present value of assets is about 3 billion, and the present value of liability was about 1.4 billion?

A. 4.4 billion.

Q. I am sorry, yes, 4.4 billion, so that the difference was about 1.4 billion?

A. Correct.

Q. That there is 1.4 billion dollars more in liabilities than in assets?

A. Correct.

Tr. Nov. 13, 2006 p.m. at 96:7-16.

Actuary Esuchanko also discussed the impact of the growing level of distributions against the falling funding of the City's pension plan:

Q. Um, looking forward now, if . . . there is an unfunded liability in this pension plan of 1.4 billion dollars, and you have a continuous escalation of distributions, at some point is the unfunded liability going to have an impact on the ability to make distributions?

A. Yes, to the extent that it is not amortized and paid off.

Q. And is there some kind of study that can be done that would tell the court if were going to fashion a remedy in the future, if the court wanted to know . . . with regard to basic trend lines, at what point would we get to the position where there would be a difficulty in making distributions, can you do that?

A. Yes, a calculation of that nature can be made.

Q. Is there some term of art that is used to describe that?

A. It is called a ruin calculation.

Tr. Nov. 14, 2006 p.m. at 56:1-19.

As this uncontroverted evidence shows, the City's pension plan has been put "at risk" by MP I and MP II. A pension plan is considered to be "at risk" under federal law if it is less than 70% funded. *See* Pension Protection Act of 2006, § 303(i)(4)(A)(ii), 26 U.S.C. 401. The funding level of the SDCERS plan has fallen below the "at risk" threshold provided by federal law, and a primary cause of this drop in funding level is the impact of MP I and MP II, which unquestionably increased benefits while simultaneously reducing funding. The result of the exchange of increased unfunded benefits for contributions below actuarially required levels has

placed SDCERS at risk. The remedy sought by the City—the unwinding of the entirety of MP I and MP II—will, if adopted, provide the City Council with the opportunity to restore the funding level so that the pension system will no longer be at risk. Every pension participant stands to benefit if this remedy is implemented after judgment and remand in this case, thereby making this a viable legislative action notwithstanding the claim of vested rights.

In all events, the Court is not persuaded that the Unions (and, by extension, their members) are "innocent" victims of the alleged conflicts of interest in light of the record of proceedings before the SDCERS Board and the City, and the trial testimony in Phase I. The evidence demonstrates without question that the Unions were complicit in what was a tri-partite arrangement between certain SDCERS Board members, certain City officials, and the Unions, to exchange benefit increases for underfunding of the system.

The contemporaneous documents demonstrate that the Unions knew that the Board was "tampering" with the funding and acquiesced in and ultimately supported that result.[13] The Unions had representatives on the Board itself, and those representatives advocated, voted for

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[13] As MEA representative Ann Smith wrote:

> I cannot state strongly enough how committed MEA's leadership . . . [is] to the following outcomes: (1) a vast improvement in the retirement formula for general members . . . .
>
> I also cannot over-emphasize that the level of employee scepticism [sic] and distrust regarding any ***tampering with funding methods*** related to the retirement system is enormous and will require a yeoman's effort by every person associated with MEA to overcome. ***MEA will not undertake this formidable task unless the gains in benefit levels for the employees MEA represents are clearly respectable*** and credible rather than de minimus [sic].

Ex. 87.1 (emphasis added). This initial reluctance by the MEA to support MP I in the absence of increased benefits is confirmed by the testimony of Judith Italiano, who explained that the MEA originally objected to the City Manager's suggestion that the City pay less than its actuarially required contribution "because there was nothing in there for the employees. [The City was] not going to pay their part and there was nothing there to be gained for the people that MEA represents." Tr. Nov. 7, 2006 p.m. at 26:17-21 (Testimony of Judith Italiano, former President of the MEA); *see also* Italiano Depo. at 314:8-16 (Ex. 2205, at 12, clip 5) (MEA's Ann Smith "proposed that we support the City's rate stabilization plan and ramp-up").

and even ***proposed*** aspects of MP I and MP II (resulting in their own benefit increases in exchange for underfunding). This information was shared with the Union members. *See, e.g.*, Tr. Nov. 7, 2006 (Testimony of Judith Italiano) at 19:6-21 (explaining that the MEA membership was informed through "Hotsheets" and other communications that "the City's willingness to include retirement benefit increases was contingent on the Retirement Board's willingness to adopt the City's proposed new terms and conditions related to contributions and funding levels"); Ex. 357 (July 1, 2002 MEA "Hotsheet") (explaining to MEA members that "[t]he availability of these benefit improvements depends on a favorable vote of the retirement board of trustees on the City's request for a payment plan which would lower the current trigger from 82.3% to 75%."). Ms. Italiano specifically testified (by deposition) as to the Union members' knowledge of the quid pro quo of benefits for funding concessions:

> What I remember is that the year before, there had been major concerns from our members about the City wanting just to take funds from the system with no benefit improvements, and this time around, we made sure that team members spoke with everyone that they could in their workplace and gave them every information they had from the table and did discuss it with people to where they were more comfortable . . . . I know that we had to assure them that we had looked at the information before us. We were comfortable with it, and they were very interested in getting their new benefit.

Italiano Depo. at 306:4-20 (Ex. 2205, page 11, clip 1). *See also id.* at 303:18-22, at 12, clip 7 ("We discussed it in extreme with everyone who voted").[14]

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[14] In addition to this evidence of direct notice, the knowledge of their Union agents is imputed to the SDCERS beneficiaries: Courts impute knowledge of the unlawful agreement to all principals who benefit from the agent's negotiation. *See* Cal. Civ. Code § 2330 ("all the rights and liabilities which would accrue to the agent from the transactions . . . accrue to the principal"); *id.* § 2332 (both principal and agent are deemed to have notice of what either has notice of, and ought, in good faith and the exercise of ordinary care and diligence, communicate to the other); Am. Jur. 2d, Agency § 273 (2006) ("Subject to certain exceptions, it is a general rule that knowledge of or notice to an agent received while acting as such within the scope of his authority and in reference to a matter over which his authority extends is imputed to and binds his principal."); *see also Sun Life Assur. Co. v. Occidental Petroleum Corp.*, 43 Cal. App. 2d 849 (1941) (a principal is charged with knowledge of the facts known by its agent). A void contract or agreement entered with the agent's knowledge accordingly may not be preserved merely to avoid harm to the agent's principals. *See Kaiser Steel Corp.*, 455 U.S. at 76, 83 n.8 (voiding illegal contract entered with the knowledge and

Ms. Italiano frankly admitted the MEA's support for the benefits-for-funding trade off:

> Q. But you were agreeing to allow [the funding for the new benefits] to be postponed. In other words, you were letting the City off the hook for purposes of having to pay for the benefits that the actuary-determined rate was not going to be paid, right?
>
> A. We agreed to allow the City to ramp up their payments over a period of time in return for an improvement in benefits.
>
> Q. Right. So that means you were going to defer where the City was going to get the money later?
>
> A. That's correct. That was their plan.
>
> Q. Why did you do that?
>
> A. It was their proposal, and it improved the benefits for our members.
>
> Q. No. But I'm asking you, though, because you agreed to it, right?
>
> A. My negotiating team agreed to it, and I signed off on it, yes.

Tr. Nov. 14, 2006 (Italiano Deposition Excerpt at 222:14-223:7, Ex. 2205, at 4, clip 3); *see also id.* at 223:17-23, at 5, clip 8 ("Q. Why did you agree to postponing the contributions? A. Because we wanted the benefits. Q. But—I understand that. But why did you agree to postponing the contributions? A. Because that was the way we were going to get the benefits").

The trial evidence also shows that the Unions were on notice that SDCERS Board members had a financial interest in MP I and MP II. For example, Ms. Italiano testified that she knew that SDCERS Board members "that worked for the City were going to get every increase that was made for anyone." Tr. Nov. 14, 2006 (Italiano Deposition Excerpt at 224:2-4, Ex. 2205, at 5, clip 8). *See also id.* at 224:19-24, at 6, clip 8 ("Q. Okay. Now, but you understood that they did have a financial interest in that decision to adopt or not adopt the City's proposed rate

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participation of a union, and without the participation of the individual represented employees, despite resulting reduction of heath and retirement funds of union members).

stabilization plan, right? A. I knew that they were going to get an improved benefit, yes"). Ms. Italiano also understood that underfunding "doesn't help the system." *Id.* at 226:19, at 6, clip 8.

The evidence from the record of proceedings before the SDCERS Board and trial evidence also confirms the Unions' direct participation contemporaneous with the adoption of the agreements. Specifically, as to MP I, on June 11, 1996, the SDCERS Board's Special Workshop minutes confirm that the "plan" was the subject of discussions between the City Manager's office ***and the Unions***, as well as the SDCERS Board:

> [Mr. McGrory] indicated that the Manager's office had been ***discussing all of the aspects of their proposal with the employee groups and seeking their concurrence with the plan.***

Ex. 276.67. *See also* Tr. Nov. 6, 2006 p.m. at 16:19-24 (Testimony of Jack McGrory) (stating that the discussions regarding the retirement system issues and the extension of the current MOUs were "all one integrated discussion"). Mr. McGrory observed:

> that he believes that these two bodies [the Manager's Office and the Board], ***along with the employee organizations***, have developed an acceptable plan that will solve the City's short and long term problems with the System . . . .

Id. at 276.78 (emphasis added). The Board also heard testimony from Union representatives, urging the Board to approve this proposal "as a means to allow the general member's benefit levels to be increased . . . ." Ex. 276.147. Confirming their participation, the four City Union presidents signed agreements in June 1996 that tied increases in benefits to the SDCERS Board agreeing to allow the City to pay less than the actuarial rate to the City's pension fund. Ex. 155.5, 155.13, 155.21, and 155.28.

On July 2, 1996, the City Council adopted Resolution No. 287582, adopting MP I. *Id.* at 155.1. That Resolution reflects that the Unions agreed to the proposed benefit increases "subject to the occurrence of various contingencies contained within the proposal." *Id.* at 155.1. The resolution therefore approves the benefit increases "contingent on an affirmative vote of the participants." Ex. 155.2. ***Each of the Management Proposals to the Unions was conditioned upon the Union's acceptance of the Manager's Proposal to SDCERS***. *See* Ex. 155.3, 155.12,

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155.20, and 155.28. MEA President Judith Italiano testified that all of the Unions had to approve MP I. Tr. Nov. 7, 2006 p.m. at 50:5-20.

As for MP II, the Deputy City Manager, Bruce Herring, presented the modified proposal, again in the context of "labor negotiations":

> [H]is proposal is ***in the context of some labor negotiations*** that were recently completed with most of the City's employee labor representatives. What [Herring] is presenting today are ***the implications of these negotiations as they relate to the System and its funding trigger. Although they are separate issues, they are tied into the tentative labor agreements***.

Ex. 276.179 (emphasis added). Similarly,

> Mr. Grissom reported that these issues evolved out of ***the meet and confer process*** [between the City and the unions], ***in which a number of benefit enhancements were agreed upon, but made contingent upon the Board's approval of the Manager's funding proposal . . . . What the City is asking the Board to do is approve . . . a funding mechanism that would allow these benefit enhancements to be conferred.***

Id. at 276.180 (emphasis added).

Indeed, the record repeatedly reflects that MP II arose out of "labor negotiations":

> The City, ***through labor negotiations***, agreed that the 2.50% at age 55 [increase] is an appropriate benefit to bestow. The City, however, was not willing to grant this benefit, given the cost, if at the same time, it might be facing a jump in retirement contribution rates to full actuarial rate (+$25 million) as a result of the "trigger." Consequently, the City agreed ***contingent*** upon the resolution in this proposal.

Ex. 1350 (some emphasis in original). On July 11, 2002, when modified MP II came before the SDCERS Board for approval, the discussion again confirmed that MP II was the product of union negotiations:

> ***He [Mr. Grissom] explained that during this year's meet and confer process, the City and Labor Organizations agreed to some benefit enhancements which were subject to the Board's approval of a modification of the 1996-1997 Manager's Proposal.***

Ex. 276.203 (emphasis added).

The trial evidence includes May 2002 letters and a memorandum memorializing offers made directly to the City's four unions that directly tied increased benefits to reduced

contributions. These documents each contained, with slight variations, the following message to union leaders:

> Substantial benefit improvements granted by the City since the adoption of the "City Manager's Retirement Proposal" dated July 23, 1996 [MP I] have created additional unfunded liability to SDCERS that was not anticipated when the City agreed to the "trigger" provisions. Significant improvements to benefits are contained in this three-year proposal. Consequently, the "trigger" provisions must be adjusted as a condition of the City's three-year proposal. Therefore, ***this three-year proposal is contingent upon, and subject to, approval by the SDCERS Board of Trustees of an adjustment to the "trigger" provisions contained in the Manager's Proposal [I]*** . . . .

See Tr. Ex. 272.2, 272.6 (City of San Diego Proposal to the Municipal Employees Association, May 13, 2002) (emphasis added). *See also* Ex. 311.2 (Proposal to AFSCME Local 127, dated May 13, 2002) (same); Ex. 274.3 (Proposal to Firefighters Local 145, dated May 13, 2002) ("this three year proposal is contingent upon, and subject to, approval by the SDCERS Board of Trustees of an adjustment to the 'trigger' provisions contained in [MP I]"); Ex. 282 at 2 (Proposal to Police Officers' Association, dated May 24, 2002) ("this three year proposal is contingent upon, and subject to, approval by the SDCERS Board of Trustees of an adjustment of the 'trigger' provisions contained in [MP I]"); Ex. 357 (MEA Hotsheet) ("UPDATE: Member Ratify Contract Contingent Upon Retirement Board Decision . . . . The availability of these benefit improvements depends on a favorable vote of the Retirement Board of Trustees on the City's request for a payment plan, which would lower the current 'trigger' from 82.3% to 75%. The Retirement Board of Trustees will meet July 11th . . . Please attend this meeting – we need your support"); Tr. Nov. 13, 2006 at 29:5-9 (Testimony of Dan Kelley).

Ann Smith, representing MEA, wholeheartedly supported MP II before the Board, saying that it "is an important part of MEA's analysis to seek benefit improvements which includes doing its own analysis, to retain its own advisors regarding the City's budget," to protect the represented employees. *Id.* at 276.223. She stated: "***Having reviewed the Manager's proposal, MEA has confidence in the integrity of what is being presented. If not, they wouldn't have supported it.***" *Id.* (emphasis added). "She [assured] the Board that its support for the Manager's Proposal is important to 5,000 represented employees. ***MEA has confidence with its***

analysis that this is an appropriate proposal." *Id.* (emphasis added).[15] Ed Lehman spoke on behalf of Local 127, and he supported the proposal and "encouraged the Board to act on this proposal today." Judith Italiano likewise supported the measure and urged MEA's membership to support the proposal. Ex. 358 ("Hotsheet" urging MEA membership to vote to approve MP II).[16]

After fiduciary counsel, Mr. Blum, stated his opinion of the June 18, 2002 proposal, as to whether counsel "thinks the Board would be sued if the proposal were approved," *id.* at 276.232, that "yes, there is a material risk that the court could find that the Board didn't fully exercise its fiduciary responsibilities in approv[ing] this," *id.* Board Member (and Union President and City employee) Ron Saathoff ***enabled passage of MP II,*** bringing a substitute motion in lieu of the June 18 Manager's Proposal. *Id.* at 276.234.

The trial evidence reflects that the Saathoff motion was a pre-planned maneuver. *See* Ex. 277 at 2 (Lexin Memorandum to City Council dated July 8, 2002) ("Based on our conversations with the Retirement Administrator, we anticipate a motion from a Board member

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[15] *See* n.3, *supra* (explaining that contrary to Ann Smith's statements to the Retirement Board, former MEA President Italiano testified that MEA did not do any independent analysis regarding the feasibility of the City Manager's proposal. Tr. Nov. 7, 2006 p.m. 76:6-20 and 77:14-22).

[16] Judith Italiano, the former MEA President, has confirmed that the deal was benefits for funding and that the deal was contingent on the SDCERS Board's approval. *See* Tr. Nov. 7, 2006 p.m. (Testimony of Judith Italiano) at 17:20-18:3 ("Q. You had full knowledge and notice that the benefits that would have been negotiated in 2002 were conditioned upon SDCERS agreeing to the terms [of MP II]? . . . A. I knew that there were requests of the City Manager to the Retirement Board that had to be taken care of before we could get our bargained agreement, yes."); *see also id.* at 70:16-71:7 (Q: "Was it your understanding that the additional increase to 2.5 was conditioned upon M.E.A. going along with the changing of the trigger from 82.3 percent to 75 percent? A. The City asked us to support their request to the Retirement Board, as part of giving us those benefits, yes. . . . Q. You agreed to that, the proposal? A. We agreed to support to the Retirement Board what the manager was asking, yes."); *see also id.* at 19:6-21 (explaining that the MEA membership was informed through "Hotsheets" and other communications that "the City's willingness to include retirement benefit increases was contingent on the Retirement Board's willingness to adopt the City's proposed new terms and conditions related to contributions and funding levels"); Ex. 357 (July 1, 2002 MEA "Hotsheet") (explaining to MEA members that "[t]he availability of these benefit improvements depends on a favorable vote of the retirement board of trustees on the City's request for a payment plan which would lower the current trigger from 82.3% to 75%.").

which would further modify the proposal before the Board, by eliminating the request to lower the funded ratio floor, and including the five-year phase in if the trigger (82.3 % funded ratio) is effectuated"). *See also* Ex. 373 (closed session minutes approving modification if necessary).

The MEA celebrated the ultimate approval by the Board, which "took care of the 'contingency' part of our contract regarding retirement benefits." Ex. 382 (MEA e-mail dated July 11, 2002); *see also* Ex. 331 (July 12, 2002 MEA "Hotsheet") ("contingencies of our ratified agreement [have] been met" which will "greatly enhance [members] City benefits").[17]

Finally, the record confirms that "Retirement Board's Assistant General Counsel prepared the ordinance to amend the Municipal Code to make ***the changes agreed to by*** the City's Management Team and ***the four labor organizations*** and approved by the City Council. . . ." Ex. 74.3 (emphasis added).

As discussed, the policy behind Sections 1090 and 1092 (and the conflict of interest laws generally) brooks no exception—even innocent beneficiaries of an illegal contract or legislation may be impacted and the interests of the taxpayers in uncorrupted decision-making and expenditures prevail. There can be no doubt about the fairness of the result of a voiding of the agreements, however, when the equities, too, support this result because the Unions and their representatives on the SDCERS Board knew full well that the they were acting against the fiduciary interests of the pension system. Indeed, they were expressly advised by counsel and by

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[17] Ms. Italiano's testimony on whether she had been told by Mr. Uberuaga that the contingency had been met for MP II was inconsistent, at best. In her deposition, played at trial, Italiano said that Uberuaga call her on July 11, 2002, and said that the City and MEA had a deal and "it did not include a contingency." Ex. 2205 at 260:12-261:09, at 13, clip 2. When confronted with the July 12 Hotsheet (Ex. 331), however, Italiano admitted that Uberuaga told her the "contingencies had been met." Ex. 2205 at 274:01-21, at 14, clip 4. In her direct testimony at trial, Italiano gave a far different story, stating that the agreement was for MEA's support of the proposal "as far as contingencies in our ratified agreement that the City would give approval upon [MEA] support of [MP II] . . . ." Tr. Nov. 8, 2006 a.m. 29:7-22. Finally, when confronted with her deposition testimony, Italiano altered her story again. Tr. Nov. 8, 2006 a.m. 31:20-33:1. Under California Civil Jury Instructions (CACI) 107, "[i]f you decide that a witness has deliberately testified untruthfully about something important, you may choose not to believe anything that witness said." The Court considers this instruction in discounting the credibility of Ms. Italiano.

certain Board members that this was so,[18] and it was for that reason that the Board members sought indemnification protection.[19]

Intervenors seek to avoid Section 1092 by evidence that outside counsel provided legal opinions as to whether the Board members could vote on MP I and MP II, and whether those

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[18] Fiduciary counsel to the Board, Mr. Hamilton, states that MP I raised "red flags" regarding the Board's duty to the system itself:

> He stated that there were "red flags" raised in his mind by this proposal as it relates to the Board's duty of loyalty to the integrity of the fund. . . .

Ex. 276.84. Further,

> he reminded the Board that the pension beneficiaries and members have a vested right to an actuarially sound system and that the Board has a duty of loyalty to the integrity of the fund that can not be contracted away.

Id. at 276.86. Another Board member, Ms. Parode, echoed this point, stating that "current employees would be excited about receiving improved benefits," and therefore it was the fiduciaries' duty to be "concerned about the long-term funding of the System." *Id.* at 276.88.

As for MP II, the System's actuary, Mr. Roeder, again cautioned on the fiduciary breach:

> In isolation, there is nothing wrong with enhanced benefits, which people tend to favor. There is also nothing wrong with contribution relief—in isolation. However, ***when enhanced benefits come at the same time as contribution relief, the Board must be cautious***. The Manager's Proposal has been in effect for five years, ***which has allowed the City to pay less than the actuarially assumed rate. The role of a fiduciary must be independent of the setting of existing or potential benefits. He can only urge that in the future, those two functions be truly segregated.***

Ex. 276.180 (emphasis added).

[19] Fiduciary counsel, Mr. Blum, warned:

> [He] said the proposal posed a material risk if this were litigated in court. The judge could find that approval of the proposed amendment to the 1996 Proposal was not a prudent exercise of the Board's fiduciary duties, which would be based on the facts before the Board and fiduciary counsel at that time . . . . ***In a worse case scenario, the Board and City could be sued. . . . If this were to happen, a number of things could occur. The judge could tell the Board anything from reconsidering its action all the way up to holding each Trustee personally liable for losses. . . .***

Ex. 276.187 (emphasis added). The Motion to Approve the Manager's Proposal was then amended, to make Board approval contingent upon receiving "acceptable, written confirmation from the City that it would indmenifiy [sic] trustees in any lawsuits arising out of actions being taken by this Board." Ex. 276.230 (capitalization omitted).

approval of those proposals constituted a breach fiduciary duty. However, not only did outside counsel raise concerns about fiduciary duty breaches, as noted, but the opinions cited by the Unions are not supportive of their position. In the case of Mr. Hamilton on MP I, the opinion was conditioned upon a credit-like review of the City's ability to pay the potential balloon payment, and no such review was shown to have occurred. In the case of MP II, there was no evidence any such opinion was read, received or relied upon. And, most importantly, under the prohibitions of Section 1090, reliance on advice of counsel is not a defense. As the court wrote in *Thomson v. Call*,

> The trial court's remedy is . . . consistent with a long, clearly established line of cases. Admittedly, the resulting forfeiture seems harsh under the facts of this case. Call was not found to have committed fraud, actual or constructive, or to have conspired to violate section 1090. Indeed, ***he did seek and obtain advice from the city attorney on certain occasions, and he did follow the specific advice he received***. No evidence in the record supports an inference that Call actually initiated the entire transaction, and there is conflicting evidence as to the difference between the fair market value of the parcel and the amount IGC actually paid for it . . . .
>
> However, examination of the goals and policy concerns underlying section 1090 convinces us of the logic and reasonableness of the trial court's solution. In *San Diego v. S.D. & L.A.R.R. Co.*, we recognized the conflict-of-interest statutes' origins in the general principle that "no man can faithfully serve two masters whose interests are or may be in conflict": "The law, therefore, will not permit one who acts in a fiduciary capacity to deal with himself in his individual capacity . . . ." "The instant statutes are concerned with ***any*** interest . . . which would prevent the officials from exercising absolute loyalty and undivided allegiance to the best interests of the city."

38 Cal. 3d at 647-48 (citations omitted; some emphasis added). Thus, reliance on advice of counsel will not avoid the mandatory forfeiture remedy of the conflict of interest laws. *See also Chapman v. Super. Ct.*, 130 Cal. App. 4th 261, 274 (2005) ("reliance on legal counsel's advice is not a defense to a section 1090 violation").

Contrary to what occurred, under *Carson*, when the Unions learned of the request by City officials to underfund the system in exchange for increased benefits, the matter should have been reported to authorities. The *Carson* court made the reporting rule explicit:

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> Our holding sends a message. If a corrupt public official demands an extortion payment in exchange for a public contract, the victim should not pay. Instead, the victim should report the corrupt public official to local, state, or federal law enforcement. If the victim pays and the extortion is discovered, the victim will not be permitted to retain any consideration received. The reason is simple. A public contract obtained through an extortion payment is not valid, and no one should believe that it is valid. A bright line rule is required.

Carson Redev. Agency v. Padilla, 140 Cal. App. 4th at 1337.

As discussed, then, there can be no ratification or estoppel which will cure a conflict of interest law violation. The only remedy is to have new official action after disclosure of the financial interests, without the participation of the conflicted officials, and with the requisite consideration of the rule of necessity, as discussed below. *See, e.g.,* Cal. Gov't Code § 87105. That singular remedy was supported by the trial testimony. For example, Mr. McGrory testified that he learned of the corrective steps needed to resolve instances in which City officials voted on matters in which they had a financial interest. Tr. Nov. 6, 2006 p.m. at 49:17-51:13. Mr. McGrory explained: "Well, the Council had voted on an item in which they had—had a potential to benefit from, in some way, then that would have been a conflict, and it would not have been appropriate for them to have voted, so the Council would revote the item, with that Council member taking a walk and abstaining." *Id.* at 50:27-51:5. Mr. McGrory also explained that the revote would take place after full disclosure about the conflict of interest. *Id.* at 51:6-8.

The Intevenors offered no proof that such a cure occurred in this case. Thus, an essential element required for correction of the (presumed) conflict of interest law violation was missing. The Intervenors bearing the burden of proof on this issue, it must be resolved against them.[20]

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[20] While Intervenors have argued that the *Corbett* and *Gleason* settlements provided such a ratification or cure, as discussed below, neither settlement resolved the essential issue of the legality of benefits under MP I and MP II and implementing legislative actions. Moreover, Bruce Herring, who admittedly held a prohibited financial interest in MP I and MP II, Tr. Nov. 15, 2006 a.m. at 51:14-52:20, while serving as an architect of both proposals, also participated in the *Corbett* and *Gleason* settlements, *id.* at 53:6-18.

C. **Complexity of the Alleged Wrongdoing Does Not Preclude a Remedy**

In asserting that this Court is unable to fashion a remedy for any Section 1090 violation, the Unions have focused on the complex interrelationships surrounding MP I and MP II, which involved not only the original agreements themselves, but also implementing legislation and employee collective bargaining agreements. Given the case law and the strong public policy underlying state conflict of interest laws, however, the Court finds that the complexity of the circumstances does not preclude a judicial remedy.

First, Section 1090 case law emphasizes that all related transactions or events should be considered. "[I]n considering conflicts of interest [courts] cannot focus upon an isolated 'contract' and ignore the transaction as a whole." *People v. Honig*, 48 Cal. App. 4th 289, 320 (1996); *see also Gnass*, 101 Cal. App. 4th at 1294 (reviewing California law and stating that courts "look[] past the individual contracts in question and consider[] the relationships between all the parties connected with them, either directly or indirectly, to determine if a conflict of interest existed."); *see also Chapman v. Super. Ct.*, 130 Cal. App. 4th 261, 274 (2005) (the "term contract is interpreted broadly under section 1090 and includes 'the negotiations, discussions, reasoning, planning, and give and take [that] go beforehand in the making of a decision'"); *Campagna v. City of Sanger*, 42 Cal. App. 4th 533, 541 (1996) (related agreements must be viewed with reference to one another in applying Section 1090).

Thus, courts should not be "concerned with technical terms and rules applicable to the making of contracts, but instead [with] rules governing the conduct of government officials." *See Honig*, 48 Cal. App. 4th at 314-15; *see also Stigall*, 58 Cal. 2d at 569. It is critical to ascertain the true nature of officials' relationships, no matter how complicated a transaction may be. *See Honig*, 48 Cal. App. 4th at 315 (citing *People v. Watson*, 15 Cal. App. 3d 28, 37 (1971)).

Indeed, the California Supreme Court has made clear that Section 1090 will sweep in all aspects of the tainted official action, both contractual and legislative. *See Thomson v. Call*, 38 Cal. 3d at 644 (finding single multi-party agreement based upon "IGC's letters proposing the $600,000 plan, ***the relevant resolutions adopted by the city council,*** the acceptance of the deeds

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and ratification of the purchases made by IGC, the use and building permits, and the real estate purchase contracts") (emphasis added).

In addition to *Thomson v. Call*, examples abound of courts viewing multi-party agreements, such as the ones here, as single transactions, particularly when necessary to protect the public from conflict-ridden deals. In *People v. Honig*, for example, defendant Superintendent of Public Instruction and Director of Education was directly involved with a non-profit group ("QEP") in that his wife was employed by them and they rented office space from him. *Id.* at 304-05. The non-profit needed funding for employee salaries, so Honig arranged for Department of Education grants to cover their salaries. *Id.* at 307-11. The court viewed all the transactions—Honig's arranging for the grants, the payment of DOE funds to the QEP employees, and the employees' work for QEP—as the performance of a single agreement. *Id.* at 320. *See also People v. Vallerga*, 67 Cal. App. 3d 847, 869 (1977) (county assessor had financial interest in a contract when his private consulting fee was contingent upon the execution of the county's contract with the city; private agreement for a consulting fee and the contract with the City were considered as a single transaction); *People v. Darby*, 114 Cal. App. 2d 412, 418-19, 428-30 (1952) (construing defendant's lease contract and the school district's arrangements for the ice cream contract together in order to follow defendant's trail of interest). *Id.*

While this is an issue that will be tried in Phase III, as the Court has previously found, there is evidence suggesting that the SDCERS Board members' conflicts of interest tainted the implementing legislative actions, by linking the benefit increases and the underfunding that were the subject of both, since the latter enabled the former. Indeed, the linkage between the benefit increases and contribution reductions has been admitted by SDCERS in its pleadings in this case. *See* SDCERS Compulsory Cross-Complaint (dated March 24, 2006) ¶ 14 ("MP I . . . allowed the City to contribute less funds than what was actuarially required pursuant to Charter Section 143 by promising that retirement benefits certain members of the Former Board . . . would be entitled to receive would be increased"); *Id.* ¶ 19 ("MP II . . . allowed the City to continue to contribute less funds than what was actuarially required pursuant to Charter Section 143 and

eliminate the safeguard balloon payment, by promising that additional retirement benefits for certain members of the Former Board . . . would be increased").

In addition, the same City officials (Herring, Lexin, Webster and others) allegedly were involved in developing, adopting, enabling and implementing the entire course of alleged unlawful conduct—from MP I and MP II, through the Union MOUs and the implementing legislation, and extending through the *Corbett* settlement—while financially interested in those official actions.

For example, with MP I, Bruce Herring was a member of the SDCERS Board when it considered MP I. He admitted he was "on the board from January '96 through December 2000," which included "the Manager's Proposal 1 time frame." Tr. Nov. 15, 2006 a.m. at 51:14-19. Herring admitted that he voted for MP I. *Id.* at 51:20-21. He also admitted that he received an increase in benefits "as a result of the benefits approved by the City Council at the same time approximately that MP-1 [was] being considered by the board." *Id.* at 52:1-20. Herring admitted that he attended closed sessions of the SDCERS Board. *Id.* at 57:11-13.

Jack McGrory identified the following City employees who served on the Board while MP I was considered: Keith Enerson from the Police Department; Ron Saathoff from the Firefighters; Bruce Herring; Terri Webster from the Auditor's Office; Sharon Wilkinson; and Cathy Lexin. Tr. Nov. 6, 2006 p.m. at 5:7-17. McGrory admitted that Cathy Lexin was "the City's principal labor relations manager" during the end of McGrory's time as City Manager, and that she worked under and reported to Bruce Herring. Tr. Nov. 6, 2006 a.m. 16:5-14.

Bruce Herring acknowledged the admission that substantial retiree and active member benefits were tied to and contingent upon the approval of MP I. Tr. Nov. 16, 2006 a.m. at 17:27-18:7. The July 11, 2002 Board Minutes confirm the admission by Ms. Lexin that benefit increases were tied to MP I:

> Ms. Lexin said her understanding is that the City is before this Board with this request because of projections that Mr. Roeder just confirmed; that there was a good chance we would hit the floor; in that the City would be faced with a $25 million hit to next year's budget. This is why the City has come to the Board with this proposal. Contrary to Ms. Jamison's statements, ***there were substantial retiree and active member benefits tied to the '97 MP***

[MP I] and consideration was given to the employer that all three occurred at the same time and contingent upon each other.

Tr. Ex. 276.226 (emphasis added).

Mr. Herring also admitted he was on the SDCERS Board while on the labor negotiating team. Tr. Nov. 15, 2006 a.m. at 56:18-26. He stated that he was a "Deputy City Manager overseeing" the 1996 meet and confer with the Unions, and that he handled "some of the negotiations directly at the table," and he "had other people who worked with me at the time handle other negotiations directly at the table." *Id.* at 56:27-57:7. According to Jack McGrory, Herring oversaw labor relations. Tr. Nov. 6, 2006 a.m. at 15:7-10. Herring also admitted he met with the City Council in closed session about labor negotiations. Tr. Nov. 15, 2006 a.m. at 56:24-26. Herring was sure in 1996 he made it clear to the "labor organizations" that the increased benefits were "dependent upon getting the MP I package through at SDCERS." *Id.* at 59:2-21.

As for MP II, the City's labor negotiator, Dan Kelley, testified that Cathy Lexin, Terri Webster and Bruce Herring were on the 2002 meet and confer executive management team. Tr. Nov. 13, 2006 a.m. at 15:24-17:19. Herring admitted he "made a description of the proposal of MP 2 to the board," which consisted of a "detailed proposal of Manager's Proposal 2." Tr. Nov. 15, 2006 a.m. at 85:4-11. He identified the City employees who worked for the administration who served on the SDCERS Board as including "Cathy Lexin, Mary Vattimo, Terri Webster." *Id.* at 85:26-86:4. Herring also stated that he was on the City Manager's strategy team on labor negotiations in 2002. Tr. Nov. 15, 2006 a.m. at 75:4-15. He also identified SDCERS Board Member Terri Webster as also serving on the City's 2002 labor negotiating team. *Id.* Additionally, Herring identified other City employees on the SDCERS Board who had a financial interest in MP II as Terri Webster, Cathy Lexin, Sharon Wilkinson, John Torres and Mary Vattimo. Tr. Nov. 15, 2006 a.m. at 85:26-86:4.

SDCERS Board Member Ron Saathoff participated in approving MP II in 2002, with a financial interest in a special retirement benefit that allowed him to include his union salary in setting the size of his retirement benefit. Herring testified that there "was an issue brought up by

the Firefighter's union on behalf of the president because of the perceived inequity between how their president was treated in the retirement system and other union presidents." Tr. Nov. 15, 2006 83:17-23. Herring testified that he "heard the conversations at the labor schedule meetings and sat through closed door sessions where" the issue of "whether or not the union salaries" could be taken into account in setting the pension benefits for presidents of the City's unions. *Id.* at 84:3-19. He also testified that he believed that Cathy Lexin participated in those discussions. *Id.* at 84:20-21. Dan Kelley, the City's labor negotiator, testified that with respect to the incumbent union presidents being able to use their union salaries to set their retirement benefits, he looked at "all of the incumbent leave [as] part of the negotiation process." Tr. Nov. 13, 2006 p.m. at 46:20-47:15.

Herring also admitted that in the *Corbett* litigation, he represented "the City Manager and the City Council along with the City Attorney's office, and an outside attorney in the negotiations." Tr. Nov. 15, 2006 a.m. at 65:27-66:3. Herring stated that he was "one of the lead negotiators on behalf of the City trying to work out a settlement with the other parties." Tr. Nov. 15, 2006 a.m. at 66:16-21. In the course of his involvement in the meet and confer negotiations related to the *Corbett* litigation, according to Herring, the matter "morphed into a settlement slash labor negotiations" which "ended up in very long discussions with everybody." Tr. Nov. 15, 2006 a.m. at 98:16-21, 98:28-99:9.

Moreover, even assuming the Board's and the City officials' alleged improper relationship to the benefit increases was secondary, Section 1092 requires courts to void transactions involving both direct and indirect interests. *See, e.g., Carson Redev. Agency v. Padilla*, 140 Cal. App. 4th at 1133-34; *Terry v. Bender*, 143 Cal. App. 2d 198, 206-07 (1956) ("The public officer's interest need not be a direct one, since the purpose of the statutes is also to remove all indirect influence of an interested officer as well as to discourage deliberate dishonesty."); *Fraser-Yamor Agency, Inc. v. City of Del Norte*, 68 Cal. App. 3d at 218 (official had financial interest despite fact that his benefit was indirect). Courts have interpreted the scope of prohibited activity broadly, guided by the public policy that conflict of interest statutes are to be liberally construed. *Thomson*, 38 Cal. 3d at 645.

Confirming that the SDCERS Board members and City officials cannot avoid their alleged conflict of interest by "segmenting" their alleged wrongdoing into component parts—*e.g.*, the Board's underfunding concessions in MP I and MP II, which in turn influenced the City to implement the benefit increases (by approving MOUs and adopting resolutions and ordinances)—is the Political Reform Act ("PRA") regulation on "segmentation," applicable by analogy. *See* 65 Ops. Cal. Atty. Gen. 41 (1982), *available at* 1982 WL 156029 at *14 & n.10 (construing Section 1090 in a manner that is consistent with the similar conflict of interest provisions in the PRA; when both Section 1090 and Section 87100 of the PRA apply, the more restrictive prohibition on conflicts of interest will control).

The PRA regulations provide that an "agency may segment a decision in which a public official has a financial interest, to allow participation by the official, provided all of the following conditions apply: (1) The decision in which the official has a financial interest ***can be broken down into separate decisions that are not inextricably interrelated to the decision in which the official has a disqualifying financial interest***; (2) ***The decision in which the official has a financial interest is segmented from the other decision***; (3) The decision in which the official has a financial interest is considered first and a final decision is reached by the agency without the disqualified official's participation in any way . . . ." 2 Cal. Regs. § 18709(a) (emphasis added). Critically, "***decisions are 'inextricably interrelated' when the result of one decision will effectively determine, affirm, nullify, or alter the result of another decision.***" *Id.* § 18709(b) (emphasis added).

Because the SDCERS Board's approval of the underfunding concessions in MP I and MP II is alleged to have determined, affirmed and enabled the City's approval of the benefit increases, the two actions are "inextricably interrelated." *See, e.g.*, Tr. Ex. 371 at 2 (June 24, 2002 Letter by SDCERS Board Member Richard Vortmann) ("The problem is very simply that the City does not want to pay currently for what they want to give the employees. . . . Since ***the City is in essence asking the Board to be an 'enabler' to the City*** in their 'addiction', the Board at least deserves to hear everybody enunciate the truth") (some emphasis added). If proven, the conflicted Board members' and City officials' alleged course of official actions in adopting,

influencing and enabling MP I and MP II, the MOUs, and the implementing ordinances cannot be salvaged under a concept of "segmentation." Rather, because there is alleged to be an "inextricable interrelationship" between the conflicted actions, the entire course of official action would be void.[21]

D. The Judicial Remedy Is To Remand the Benefits and Funding Decisions to the City Council for Decision Free From Improper Conflicts, To Be Followed By a Validating Action, If Necessary

As discussed, the judicial remedy expressly mandated by state conflict of interest laws is that the Court set aside the void agreement, transaction or legislation in its entirety, and such remedy lies even against innocent beneficiaries and in the face of claims of ratification or estoppel. The requirement that the tainted agreements be set aside as void raises the question as to what, then, is the ultimate remedy to be ordered by this Court, assuming illegality is found in Phase III.

Focusing on the individual benefits at issue, the Unions have argued that the complex mathematical calculations and individual determinations (complicated by numerous interim agreements) render any dispositive remedy beyond the reach of this Court. The City has, at various times, suggested that the Court could enlist the assistance of a special master. The trial testimony has reflected that the mathematical and accounting complexities, while daunting, are not insurmountable.

However, the Court finds that it need not reach any of these issues to fashion a justiciable remedy should a violation be found. Rather, the case law implementing state conflict of interest law provides a ready solution: Upon the Court's determination of the illegality of the official actions, and a declaration of the resulting voidness of those actions, the Court then would remand the matter to the responsible public body (the City Council) for rehearing and new proceedings on the issues of pension benefit increases and pension system funding to be held free from the

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[21] Indeed, the Unions themselves assert an "inextricable" relationship. *See* Intervenors' Trial Brief at 34:7-8 (discussing "City's pension plan—as well as its MOUs . . . whose terms were 'inextricably intertwined'").

taint of the unlawful conflicts. That step, if desired, can then be followed by a judicial validating action, in which any remaining claims can be laid to rest in a single proceeding. This procedure has been employed in numerous conflict of interest cases.

In *Clark v. City of Hermosa Beach*, 48 Cal. App. 4th 1152 (1996), for example, plaintiffs raised a challenge to a decision of the city council based upon a conflict of interest. Applying state conflict of interest law, the court issued a writ of mandate and directed the city to rescind the council decision. Because plaintiffs were deprived of a fair hearing (*i.e.,* one free of the taint of conflict), ***the court held that the proper remedy was to remand to the council with directions requiring the council to rehear the matter and provide a fair hearing***. *Id.* at 1170-77.

Likewise, in *Downey Cares v. Downey Community Development Commission*, 196 Cal. App. 3d 983 (1987), the court held that the city's ordinance was invalid when an approving city council member had a conflict of interest, given that the redevelopment plan had a foreseeable material effect on his income as a realtor. The court therefore issued a writ of mandate invalidating the ordinance and issued an injunction restraining its enforcement. *Id.* at 988-89. The appellate court found that the trial court had properly invalidated the ordinance. *Id.* at 993, 998. *See also Kunec v. Brea Redev. Agency*, 55 Cal. App. 4th 511, 515 (1997) (affirming trial court's injunction invalidating decision of city council because two members had financial interests); *Witt v. Morrow*, 70 Cal. App. 3d 817, 820 n.1 (1977) ("when a violation has occurred, the court may set aside the official action as void"); *cf. Schaefer v. Berinstein*, 140 Cal. App. 2d 278, 289-93 (1956) (upon violation of Section 1090, city council had duty to declare resulting action void); *accord Carson Redev. Agency v. Padilla*, 140 Cal. App. 4th at 1337 ("Nothing stops [the parties affected by the set aside of the unlawful official action] from going to the City of Carson to work out a contract that is not tainted by a conflict of interest").

Thus, the Court finds that conflict of interest law provides the Court with a justiciable remedy should an unlawful conflict of interest be found in Phase III: ***That remedy would be to declare the illegal official actions—including MP I and MP II and all inextricably related***

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contractual and legislative actions—to be void, and to issue a writ of mandamus remanding the matter to the City Council for new proceedings cured of the invalidating conflict.[22]

Once the City Council conducts fair proceedings, the City can then (if necessary) obtain approval of the corrected action in a judicial validating proceeding, *see* Cal. Civ. Proc. Code §§ 860, *et seq.*, which allows all interested persons to be heard, and which operates *in rem* and thereby yields a judgment that is binding and conclusive against the agency and all other persons. *Id.*, § 870(a); *see also Embarcadero Mun. Improvement Dist. v. County of Santa Barbara*, 88 Cal. App. 4th 781, 789 (2001) ("'The purpose of the validation statutes is to provide a simple and uniform method for testing the validity of government action'") (quoting *Moorpark Unified Sch. Dist. v. Super. Ct.*, 223 Cal. App. 3d 954, 960 (1990)). The validation action is designed to obtain a prompt and complete decision regarding the validity of a public entity's action, thereby avoiding litigation delay and uncertainty that may impair the entity's ability to operate

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[22] In voiding the illegal actions, if warranted after Phase III, the Court can determine the scope of the void actions based upon the evidence. Contrary to the Unions' assertions that severance is impossible, the Court is persuaded that severance is sufficiently possible to permit proceeding. The evidence reflects that the City Council enacted salary and compensation increases in separate ordinances from the pension benefits. *Compare* Ex. 1130 (1997 compensation ordinance, O-18406), *with* Exs. 1105, 238, 230 (1997 ordinances enacting pension benefits, O-18383, 18385, 18392). None of the key pension ordinances discusses salary or compensation increases. *See* Ex. 74 (O-19121), Ex. 1105 (O-18383); Ex. 238 (O-18385); Ex. 230 (O-18392). To the extent ordinances enacting pension benefits contain other kinds of benefits (such industrial disability and death benefits), the pension provisions are entirely severable: The pension provisions that do not relate to or refer to the other benefits, can mechanically be removed from the ordinances, and the remainder of the ordinance will still be operative. *Metromedia, Inc. v. City of San Diego,* 32 Cal. 3d 180, 190 (1982) (an ordinance is severable when "the remainder . . . is complete in itself and would have been adopted by the legislative body had the latter forseen [sic] the partial invalidation of the statute or constitutes a completely operative expression of the legislative intent [and] are [not] so connected with the rest of the statute as to be inseparable.") (citation omitted). The benefits enhancements are also set forth entirely separately from other kinds of benefits. *See* Ex. 74 (Ord. 19121, Nov. 18, 2002); Ex. 1105 (Or. 18383, Feb. 25, 1997). Other non-benefit terms of MOUs can be upheld or severed under plain language of MOUs, which have a severance provision, and under Section 1090 case law, which provides that remote interests need not be invalidated. The MOUs contain severability clauses, which establish that the Unions and the City intended any invalid portions of the MOU to be severed from the rest. *See* Ex. 1121 (MOU between City and Local 145) Art. 5 Savings Clause; Ex. 1125 (MOU between City and AFSCME) Art. 4, sec. 2; Ex. 1117 (MOU between City and MEA) Art. 55, sec. 2. Moreover, to the extent that these matters warrant legislative solutions, they can be addressed on remand to the City Council, subject to the rule of necessity, to be followed by individual objections in a validating action, as discussed below.

financially. *Friedland v. City of Long Beach*, 62 Cal. App. 4th 835, 842-43 (1998). The Validation Act procedure is not limited to bonds or other financial instruments, but extends to situations where the lack of a prompt validating process would impair the public agency's ability to operate. *E.g., Graydon v. Pasadena Redev. Agency*, 104 Cal. App. 3d 631, 644-45 (1980). That is precisely the procedure that has been employed and affirmed on appeal in analogous circumstances.[23]

In fashioning this potential relief, the Court notes that although the parties' current pleadings seek injunctive and mandamus relief, as well as declaratory relief, none pleads specifically for a writ of mandamus directed to the City Council. Nonetheless, this Court, which is sitting in equity in this Phase I trial, has broad authority to determine and order an appropriate remedy if a violation is found. *E.g., Coons v. Henry*, 186 Cal. App. 2d 512, 519 (1960) ("It is a cardinal rule of equity practice that under a prayer for general relief the court may grant any relief conformable to the case made by the pleadings and the evidence . . . . [W]hen a party comes into a court of equity pleading facts which entitle him to some equitable relief, the court . . . will disregard the specific prayers in order to grant the relief which the proof warrants as within the equities of the entire case."); *see also Redke v. Silvertrust*, 6 Cal. 3d 94, 108 (1971) (trial court, sitting in equity, had the power to "adjust all the differences between the parties arising from the cause of action in order to do complete justice and prevent further litigation, whether or not the particular relief was requested"); *Taliaferro v. Taliaferro*, 144 Cal. App. 2d 109, 113 (1956) ("[T]he court has power, in the exercise of its equity jurisdiction, to recognize new and expanding remedies to meet new situations.").

Consistent with this authority, should the City prevail on its claims through the remaining phases of trial, the Court will permit the City to amend its complaint to conform to the City's

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[23] *See City of San Diego v. Furgatch*, 2002 WL 1575109 (4th Dist., Div. 1, July 17, 2002) (unpublished disposition) (after rehearing matter tainted by conflict of interest in earlier decision, city and redevelopment agency brought validating action for judicial declaration of validity of curative procedure). (An unpublished opinion may be considered for the value and persuasiveness of its analysis or reasoning. *See Modern Dev. Co. v. Navigators Ins. Co.*, 111 Cal. App. 4th 932, 943 (2003)).

proof at trial, specifically to plead a writ of mandate directing the City Council to set aside prior void actions and consider the matters anew.

Amendment of pleadings to conform to the proof at trial is a matter in the discretion of the trial court. *Glaser v. Meyers*, 137 Cal. App. 3d 770, 776-777 (1982) ("The trial court has broad discretion to grant or deny an amendment to a complaint at trial, and California courts have been extremely liberal in allowing such amendments to conform to proof."). Moreover, amendment to conform to proof is proper when, as here, no prejudice would result, *Walker v. Belvedere*, 16 Cal. App. 4th 1663, 1670 (1993) ("court[s] must permit an amendment to conform to proof offered by plaintiff where no prejudice results to defendant"), and when the amendment would not depend upon an entirely new set of facts, but rather is a mere formality to enable different relief. *See Rosemead Co. v. Shipley Co.*, 207 Cal. 414, 420 (1929); *see also Grudt v. City of Los Angeles*, 2 Cal. 3d 575, 584 (1970) (amendments to conform to proof are liberally allowed where the "same general set of facts" are involved).

As discussed, state conflict of interest law expressly supports a procedure whereby the matter is remanded to the appropriate official agency for new proceedings. Such a remedy may or may not be warranted at the conclusion of the trial in this case, and all interested parties may be heard on any remedy before it is selected. For present purposes, however, the Court finds that the potential for a justiciable remedy warrants proceeding to trial on the merits.

VI.

THE CITY'S CLAIMS THAT THE MP I AND MP II BENEFITS ARE NULL AND VOID MAY PROCEED DESPITE THE *GLEASON* SETTLEMENT

The *Gleason* settlement resolved litigation brought by a former City employee challenging alleged underfunding of the City pension system. In 2004, the City settled *Gleason* in an agreement which promised to make actuarially-required contributions to SDCERS commencing in 2006 and on an ongoing basis thereafter. *See* Ex. 433 (Settlement Agreement in *James F. Gleason, et al. v. San Diego City Employees' Retirement System, et al.*, San Diego Superior Court Case No. GIC803779 (hereafter "*Gleason* settlement"). The Unions contend that there can be no continued violation of the law under MP I and MP II because those agreements

were terminated under the *Gleason* settlement, and thus the City seeks an improper advisory opinion in this lawsuit, or the City's claims are barred by res judicata. The Court is not persuaded by either argument.

A. The City Does Not Seek An Advisory Opinion

The argument that the City seeks an improper advisory opinion given the *Gleason* settlement lacks merit. Not only does that argument ignore the ongoing alleged obligation to pay invalid benefits, but neither Section 1090 nor the legality of pension benefits was litigated in the *Gleason* action, which involved the system's funding. Tr. Nov. 8, 2006 p.m. at 43:13-17 (Pestotnik testimony). The settlement of the *Gleason* litigation, approved by the Court on July 26, 2004, merely restructured the unfunded liability created under MP I and MP II; the settlement did ***not*** address the legality of or set aside the pension benefits granted thereunder. *See* Ex. 433 (*Gleason* settlement); *see also infra at* 78-79 & n.26.

Thus, although MP I and MP II were ***prospectively*** terminated as a funding mechanism, ***MP I and MP II allegedly continue to obligate the City to fund—on an ongoing basis—past and future benefit increases resulting from those unlawful agreements.***[24]

Accordingly, there remains an actual and justiciable controversy as to the legality of benefits granted under MP I and MP II. An action for declaratory relief is authorized when an actual controversy exists relating to the legal rights and duties of the respective parties. Cal. Civ. Proc. Code § 1060. A declaratory relief action is proper to secure an adjudication of rights or duties between parties interested under a written instrument or contract. *Id.*; *see also Gardiner v. Gaither*, 162 Cal. App. 2d 607, 621-22 (1958). In its complaint (which is joined by the Unions in their pleadings), SDCERS sought a declaration as to "the legality of payment of retirement benefits to its members." *See* SDCERS Complaint for Declaratory Relief (filed July 26, 2005) at 5, ¶ 24. Specifically, SDCERS sought a declaration regarding the legality of payment of

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[24] The Unions' argument that MP I and MP II were terminated with the *Gleason* settlement, rendering any determination of the validity of the benefits conferred thereunder an "advisory" opinion, is facially inconsistent with the Unions' assertion that they have ongoing rights to the benefit increases conferred by MP I and MP II.

retirement benefit increases received under MP I and MP II. *See id.* at ¶¶ 22(a)-(i) (seeking, *inter alia*, a declaration regarding "[a]ny retirement benefit based on the 1996 increase of the retirement factor from 1.45% to 2.00%," "[a]ny retirement benefit based on the 2002 increase of the retirement factor from 2.00% to 2.50%", etc.). SDCERS specifically showed that "[a]n actual and justiciable controversy has arisen, and now exists, between SDCERS and the defendant [the City], as to whether the City Retirement Benefits which SDCERS has paid, and continues to pay . . . can properly and legally be paid to those SDCERS members who are retired employees and their beneficiaries." *See* SDCERS Complaint for Declaratory Relief (filed July 26, 2005) at 6, ¶ 28. ("An actual and justiciable controversy has arisen, and now exists, between SDCERS and the defendant [City], as to whether the City Retirement Benefits which SDCERS has paid, and continues to pay . . . can properly and legally be paid to those SDCERS members who are retired City employees and their beneficiaries"); *id.* at ¶ 32 ("This judicial determination is necessary and appropriate at this time so that the parties can ascertain their respective rights and duties"). SDCERS and the Unions thus plainly have admitted a ripe controversy for declaratory relief (not an effort at obtaining an "advisory opinion").[25]

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[25] *See also* Ex. 2190, San Diego Municipal Employees Association's Complaint in Intervention, filed August 10, 2005, at 12 (¶ 1) (MEA's Prayer for Relief: "That Plaintiff SDCERS' request for a judicial determination that it may properly and legally continue to pay all pension benefits pursuant to the San Diego Municipal Code . . . be granted"); Ex. 2188, San Diego City Firefighters, Local 145 Complaint in Intervention, dated August 2, 2005, at 4 (¶ 1) (Intervenor prays for judgment: "That this Court render a judicial determination on SDCERS's First Cause of Action that SDCERS may properly and legally pay all City Retirement Benefits"); Ex. 2189, AFSCME Local 127's Complaint in Intervention, filed August 10, 2005, at 3-4 ("Local 127 intervenes in this action in support of SDCERS' request for a judicial declaration that it may properly and legally pay all City Retirement Benefits . . . . The City Retirement benefits, including but not limited to the Contested Benefits, were lawfully adopted and implemented by the City and SDCERS"); Ex. 2189.4 (AFSCME Local 127's Complaint in Intervention, filed August 10, 2005 (Local 127 prays for: "A judicial determination that all City retirement benefits . . . are lawful and enforceable in all respects"); AFSCME Local 127's Ex Parte Application for Leave to Intervene, dated August 2, 2005, at 4 ("there is a present and justiciable controversy concerning the lawfulness of the Contested Benefits"); Exhibit 2187, Abdelnour Plaintiffs' First Amended Complaint, filed on or about August 23, 2005, at 7 (¶ 20) ("An actual and justiciable controversy has arisen, and now exists . . . as to whether the City Retirement Benefits . . . can properly and legally . . . be paid . . . .").

Because all parties concur that there is an actual, justiciable controversy regarding the legality and validity of the benefit increases granted under MP I and MP II, which persists today, this Court will not decline adjudication on the theory of an advisory opinion.

B. The City's Claims Are Not Barred By *Res Judicata*

Nor, for multiple reasons, does the *Gleason* settlement have *res judicata* effect in this case. To determine whether a claim is barred under *res judicata* principles, courts must examine whether: (1) the issue decided in the prior adjudication is identical with the one presented in the action in question; (2) there was a final judgment on the merits; and (3) the party against whom the plea is asserted was a party or in privity with a party to the prior adjudication. *Teitelbaum Furs, Inc. v. Dominion Ins. Co.*, 58 Cal. 2d 601, 604 (1962). These criteria are not satisfied with regard to the *Gleason* litigation.

First, the City was not a party to two of three actions settled in connection with the consolidated *Gleason* judgment, and therefore did not litigate the Section 1090 issue, which was not presented in the only case to which the City was a party. Tr. Nov. 8, 2006 p.m. at 83:22-84:4. As set forth in the *Gleason* settlement, *Gleason* was a consolidated action that included *Gleason v. San Diego City Employees' Retirement System, et al.*, San Diego Superior Court Case No. GIC 803779 ("*Gleason I*"); *Gleason v. San Diego City Employees' Retirement System, et al.*, San Diego Superior Court Case No. GIC 810837 ("*Gleason II*"); and *Wiseman v. Board of Administration of the San Diego City Employees' Retirement System, et al.*, San Diego Superior Court Case No. GIC 811756 ("*Gleason III*"). *See* Ex. 433 at 2 (*Gleason* settlement agreement). The settlement agreement expressly provides that the **City was not a party to the *Gleason II* or *Gleason III*, but rather only was a party to *Gleason I*.** *See* Exhibit 433 at 3, ¶¶ 5, 6; *see also* Tr. Nov. 8, 2006 p.m. at 58:24-25 (Testimony of Timothy Pestotnik, outside counsel for the City in *Gleason*) (stating that the City was not a party to *Gleason II*); *id.* at 43:3-18 (Section 1090 and *Gleason II* and *Gleason III* were not litigated or settled); *id.* at 83:2-14 ("1090 was not a claim the City was facing"; "the only thing that changed was the funding method"); *id.* at 44:10-21 (*Gleason I* was solely an underfunding case; the City and SDCERS were codefendants in that case and SDCERS did not have a claim against the City).

Significantly, Paragraph 5 of the settlement agreement, which concerned claims arising out of Government Code Section 1090, expressly provides that "the City is not a party to the *Gleason II* action." *Id.* The parties to the *Gleason* settlement therefore specifically recognized that to whatever extent Section 1090 claims were alleged in the *Gleason II* or *Gleason III* actions, the City was not made a party to any settlement of those claims. Not having been a party to *Gleason II* or *Gleason III*, the City is not bound by their settlement. *Am. Bankers Ins. Co. v. Avco-Lycoming Division*, 97 Cal. App. 3d 732, 737 (1979) ("A dismissal with prejudice in one case, however, does not result in the termination of all litigation involving the same facts. It is a judgment on the merits only as between the plaintiff in that case and defendants.").

Second, with regard to *Gleason I*, ***the City did not release the claims presently at issue in this case***, including the City's central conflict of interest claim here—a claim that was not at issue in *Gleason I*—the only case to which the City was a party. Thus, under basic preclusion principles, which narrowly confine the scope of the bar to the specific claims released when the resolution in the first case is by settlement, the City is not precluded from pursuing its claims in this case. In *Gleason I*, the plaintiffs sought only to void the contribution agreements made under MP I and MP II; they did not challenge the legality of the contingent benefit agreements.[26]

Of further and critical importance, while the *Gleason* class plaintiffs waive their claims and provide a complete release through the *Gleason* settlement, ***the City*** **does not**. The language of the release states:

Mutual Release

> Effective upon Court approval of this Agreement and the settlement, and in full, complete, and final compromise and settlement of any and all claims, ***Plaintiffs***, individually and on behalf of the Settlement Class, and each member of the Settlement Class, together with their children, heirs, successors in interest, and

[26] Tr. Nov. 8, 2006 p.m. at 46:4-8 (Testimony of Timothy Pestotnik) (stating no recollection of any effort in connection with *Gleason* to validate the terms of MP I); *id.* at 79:2-9 ("Q. So your recollection is that you never made the mayor and city council aware of the allegations of a 1090 violation? A. . . . I was not asked to brief [City officials] on 1090 and its application to . . . *Gleason I* because it wasn't alleged in *Gleason I*."); *id.* at 83:5-10 (explaining that "1090 was not a claim that the City was facing," . . . "so the City wasn't eliminating any risk on 1090 by virtue of settling with this class.").

> assigns ***hereby release***, discharge and dismiss with prejudice the City and SDCERS and/or their respective successors in interest, assigns, employees, agents, trustees, administrators, and representatives, ... from any and all claims, actual or potential that arise from the facts alleged in the complaints in the Actions, any existing or potential claims relating to the City's past annual contributions, to SDCERS . . . .

Id. at 433.13 (¶ 4) (emphasis added). The City and SDCERS were co-parties, as defendants, and did not release their claims. *Id.*; *see also* Tr. Nov. 8, 2006 p.m. at 44:10-21. By its plain terms, then, the *Gleason* settlement does not specify that the City releases any claims arising out of MP I and MP II, nor in particular its Section 1090 claims against SDCERS.

Third, the *Gleason* settlement expressly disclaims any determination of liability on the part of the City. *See* Ex. 433 (*Gleason* settlement agreement) at 15-16 (¶ 8) ("This Agreement, its constituent provisions, and any and all drafts, communications and discussions relating thereto, ***shall not be construed as or deemed to be evidence of an admission or concession by any party, including the City*** or SDCERS, and shall not be offered or received in evidence or requested in discovery in these Actions or any other action or proceeding as evidence of such [an] admission or concession. Instead, the purpose of this Agreement is to accomplish the compromise and settlement of disputed and contested claims. Nothing in this Agreement shall be construed as an admission by any party to this Agreement of any liability of any kind to any other party to this Agreement. Each party to this Agreement denies the allegations of each other party as set forth in the Actions and further denies that such party is liable to the remaining parties in any respect whatsoever for the harm or damages that may have been sustained by any other party relating to the Actions, or the circumstances set forth in the Recitals section above.") (emphasis added).

This express limitation on the City's liability also precludes a finding of *res judicata* against the City. *See Clovis Ready Mix Co. v. Aetna Freight Lines*, 25 Cal. App. 3d 276, 284-85 (1972) (holding first corporation's settlement with employee of second corporation, followed by entry of judgment of dismissal with prejudice was not *res judicata* barring subsequent lawsuit by first corporation against second corporation arising out of same event where release in settlement of first lawsuit expressly disclaimed determination of liability); *see also Bleeck v. State Bd. of*

Optometry, 18 Cal. App. 3d 415, 429 (1971) (same). *See generally* 1 Cal. Affirmative Def. § 14:17 (2006) ("The litigants or the court may exclude issues from the [res judicata] category of those that might have been litigated. In such a case, the judgment is not res judicata or collateral estoppel as to the deliberately excluded issues").

Fourth, and contrary to SDCERS's and the Intervenors' contention, the *Gleason I* action did not give rise to a compulsory counter-claim concerning the claims at issue in this case. Defendants in *Gleason I* were SDCERS and the City, who were co-parties—not adverse parties. *See* Ex. 961; *see also* Tr. Nov. 8, 2006 p.m. at 44:10-17 (Testimony of Timothy Pestotnik, outside counsel for the City in *Gleason*) (stating that the City and SDCERS were co-defendants in *Gleason I*). In consequence, there simply was no obligation—nor for that matter occasion—for the City to assert the precise claims that the City presently seeks to adjudicate. *See Atherley v. MacDonald, Young & Nelson, Inc.*, 135 Cal. App. 2d 383, 385 (1955) ("[I]n no event is a judgment in an action in which the parties were not adversaries, but only joined as codefendants, res judicata as between them in a later proceeding."). *Cf. Am. Bankers Ins. Co.*, 97 Cal. App. 3d at 735 ("As between defendants, the cross-complaint is not compulsory; it is only compulsory between plaintiffs and defendants."); *see also Banerian v. O'Malley*, 42 Cal. App. 3d 604, 612 (1974).

Finally, Intervenors have cited *Gates v. Superior Court*, 178 Cal. App. 3d 301 (1986), for the proposition that *Gleason II* and *Gleason III* should bar the City from proceeding under its Section 1090 claim because of a unity of interest between the City and the *Gleason II* and *Gleason III* plaintiffs. The Court is not persuaded. First, the City was not a party to the *Gleason II* and *III* actions, as discussed.[27] Second, *Gates* was a taxpayer lawsuit and its holding is not

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[27] Nor was the City in privity with the parties to the *Gleason II* and *Gleason III* settlement such that the City should be bound thereby, as the Intervenors contend. The personal financial interests of the plaintiffs in *Gleason II* and *Gleason III* diverge dramatically from the interests of the City and its citizens in this case. *See Citizens for Open Access v. Seadrift Ass'n*, 60 Cal. App. 4th 1053, 1070-71 (1998) ("A party is adequately represented for purposes of the privity rule 'if his or her interests are so similar to a party's interest that the latter was the former's virtual representative in the earlier action. We measure the adequacy of 'representation by inference, examining whether the...party in the suit which is asserted to have a preclusive effect had the same interest as the party to be precluded, and whether

applicable to the action brought by the City in this case.

For these reasons, the Court holds that the *Gleason* settlement does not foreclose this action.

VII.

THE CITY CAN PURSUE A CLAIM TO RESOLVE WHETHER THE DEBT LIMIT LAWS WERE VIOLATED

"[I]t must be remembered that all are presumed to know the law, and that whoever deals with a municipality is bound to know the extent of its powers." *San Francisco Gas Co. v. Brickwedel*, 62 Cal. 641, 642-43 (1882). The City claims that the benefit increases under MP I and MP II, and related changes in the Municipal Code, created unfunded City debt in violation of the liability laws which require same year debt to be matched with same year revenue. *See* California Constitution, Article XVI, § 18; San Diego City Charter § 99 (collectively "Debt Limit Laws").[28]

While the City claims that the benefit increases under MP I and MP II violated the Debt Limit Laws, SDCERS contends that the Debt Limit Laws have not been violated. SDCERS has stipulated that it will be bound by the judgment of this Court as to this issue. Accordingly, there is a justiciable controversy between the City and SDCERS as to whether the Debt Limit Laws have been violated. It is not a question of ***who*** violated the Debt Limit Laws; it is only a question of ***whether*** they were violated.

SDCERS and Intervenors contend that the benefits at issue qualify under the "obligations imposed by law" exception to the Debt Limit Laws. The City disagrees because the benefits are not required under state law, and because benefits arising from an unlawful contract can never be

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that...party had a strong motive to assert that interest. If the interests of the parties in question are likely to have been divergent, one does not infer adequate representation and there is no privity.").

[28] Article XVI, Section 18 of the California Constitution provides that "No county, city . . . shall incur any indebtedness or liability in any manner or for any purpose exceeding in any year the income and revenue provided for such year" without a two-thirds vote of the electorate. Charter Section 99 provides that "[t]he City shall not incur any indebtedness or liability in any manner or for any purpose exceeding in any year the income and revenue provided for such year . . . ."

an "obligation imposed by law" since the agreements were void *ab initio*. Accordingly, there is a justiciable controversy between the City, on the one hand, and SDCERS and Intervenors, on the other hand, as to whether there is an applicable exception to the Debt Limit Laws.

The Intervenors had the Phase I burden of proof to show that the Debt Limit Laws did not apply to MP I and MP II. Intervenors offered no proof on this issue. Therefore, the issue must be resolved against them and the Court finds that the Debt Limit Laws apply to the MP I and MP II agreements and implementing legislation. Moreover, given the evidence provided by Intervenors in Phase I, the Court cannot find that MP I and MP II fit within any exception to the Debt Limit Laws. *See Compton Comm. College Fed. of Teachers v. Compton Comm. Coll.*, 165 Cal. App. 3d 82 (1985). The Court has not determined in Phase I that the Debt Limit Laws were violated, however, as that issue is reserved for Phase III.

A. <u>The Debt Limit Laws Apply Regardless of Parties or Consequences</u>

The *San Francisco Gas Co.* case sets forth a mandatory rule: "[N]o indebtedness or liability incurred in any one year shall be paid out of the income or revenue of any future year." *San Francisco Gas Co. v. Brickwedel*, 62 Cal. at 642.[29] However unfortunate the results may be, the consequences of this mandatory rule do not limit or affect implementation of the law: "The fact that great hardships result in individual cases from an observance of the rule has been

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[29] The Debt Limit Laws establish the "pay as you go" principle as a cardinal rule of municipal finance. *San Francisco Gas Co.*, 62 Cal. at 642. As explained by the California Supreme Court, the framers of the California Constitution specifically created liability limits to avoid floating indebtedness:

> The system previously prevailing in some of the municipalities of the State by which liabilities and indebtedness were incurred by them far in excess of their income and revenue for the year in which the same were contracted, thus creating a floating indebtedness which had to paid out of the income and revenue of future years, and which, in turn, necessitated the carrying forward of other indebtedness, was a fruitful source of municipal extravagance. The evil consequences of that system had been felt by the people at home and witnessed elsewhere. ***It was to put a stop to all of that, that the constitutional provision in question was adopted.***

Id. (emphasis added).

recognized in several of our decisions, but as has been well said, 'this fact cannot afford reason for subverting the law or frittering it away.'" *Arthur v. City of Petaluma*, 175 Cal. 216, 224 (1917). The City has presented evidence that, in fact, MP I and MP II and related actions to implement them violated the Debt Limit Laws.

For example, as to MP I, Exhibit 84.3, a September 19, 1996 letter to Lawrence B. Grissom, SDCERS Administrator, from fiduciary counsel Dwight Hamilton, questions whether the Board's fiduciary obligation required it to investigate "whether the Board has a duty to determine the financial viability of the City before it approves contribution payments at a level less than that recommended by the actuary. In our opinion, the board does have that responsibility." Union negotiator John Thomson also observed, as to MP I, "they were just gonna pay for it over time . . . ." Tr. October 31, 2006 p.m. at 56:13-18.

As to MP II, Richard Vortmann, a SDCERS Board member, testified that "[v]ery clearly in regard to the pension and in the worse with the retiree health, that the City was not paying its bills currently. They were referring liability into the future." Tr. November 15, 2006 a.m. at 6:6-9. He further testified "that the City was incurring [liability] today and pushing off the payment of those [liabilities] to the future years." Tr. November 15, 2006 a.m. at 6:3-12. *See also* Ex. 371.2 (Vortmann letter stating: "The problem is very simply that the city does not want to pay currently for what they want to give the employees. They clearly are addicted to the 'give now, pay later' or 'burden the future year's taxpayers' when they no longer have any say in the decision – i.e., the decision being locked down now, with the mandatory bill being paid later." (emphasis in original.) *See also* Exhibit 2205, Italiano Deposition Excerpt at 197:22-198:4, at 4-5, clip 4 ("Q. Was it your understanding that essentially you were, by doing this, agreeing to basically create more debt that the City was going to have to pay later? A. I did not—yes, I understood that the City was going to defer part of what was owed, yes. Q. And who was going to pay for that? A. The City.").

Evidence has been presented that instead of funding these retroactive and future benefits in 1996 and 2002, when they were incurred, SDCERS instead entered into contribution deferral agreements by authorizing contributions of tens of millions of dollars less to the pension system

than was required by law. *See, e.g.*, Ex. 276.136 (Minutes of the SDCERS Board meeting of June 21, 1996) (SDCERS Board member Ann Parode said MP I appeared to be a borrowing of money from the fund and inquired whether the Board's obligation in managing this fund should include future generations as well as today's employees and retirees). *See also* Ex. 276.137 (Minutes of the SDCERS Board meeting of June 21, 1996) (Ms. Parode said that the Board needs to ensure that the City is not deferring a liability that in due course it would have a more difficult time paying in the future. She asked that Dwight Hamilton, the Board's fiduciary counsel, research the question of whether she should have some concern about the City's ability to pay this burden in the year 2008).[30]

Additional evidence of the deferred nature of the debt includes the testimony of Judith Italiano that she understood that there was an unfunded liability. Tr. November 7, 2006 p.m. at 100:21-24, as well as video clips from her deposition shown at trial.[31]

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[30] The City did not in fact pay any money to fund the benefits, and the allegedly surplus earnings were retirement fund assets, and not City money. As MEA President Judith Italiano testified: "Q. Where was the money going to be made up that wasn't being contributed as was required by the actuarial contribution? A. . . . I think we were all expecting from what we knew about it that the earnings of the system . . . were going to grow," and "as everyone made their contributions and the assets grew, that it would equal out at the end." Tr. Nov. 7, 2006 p.m. at 32:21-33:14.

[31] August 17, 2006 Deposition Testimony (referring to MP I: "We agreed to allow the City to ramp up their payments over a period of time in return for an improvement in benefits." Ex. 2205, at 4, clip 3 (222:15-21)).

She understood the City was creating more debt that was going to be paid later. Ex. 2205, at 4, clip 4 (197:22 -198: 02).

> Q: So you understood what you were doing here was agreeing to postpone the payment of the pension benefits to taxpayers in later years?
>
> A: Correct. So that the taxpayers could get services immediately, they were going to pay later down the road.
>
> Q: Well, the same taxpayers wouldn't be paying later, would they?
>
> A: I have no idea. Probably not.

Bruce Herring, a Board member and Deputy City Manager, also testified that MP I decreased contributions below the actuarial required contribution rate and at the same time increased benefits. Tr. November 15, 2006 a.m. at 90:6-11. He acknowledged that the unfunded liability of the system "would have to be paid off over the amortization period . . . in the later years . . . in the end . . . ." In other words, "they were postponing the full payment." *Id.* at 90:12-21.

As noted, while the Court does not now rule as to whether the Debt Limit Laws have been violated, sufficient evidence, not rebutted, has been presented by the City that MP I and MP II may be prohibited by the Debt Limit Laws to establish a justiciable controversy on that point.

B. Intervenors Have Shown No Exceptions to the Debt Limit Laws

Given that there is a justiciable controversy regarding the Debt Limit Laws, all that remains on this point in Phase I is to resolve whether there is an applicable exception to the Debt Limit Laws and whether Intervenors have carried their burden to prove such exception. SDCERS and Intervenors have asserted that pension benefits are "obligations imposed by law" that are exempt from the Debt Limit Laws. Because it was the burden of Intervenors at this phase of the trial to prove that MP I and MP II fell within an exception to the Debt Limit Laws, and because they offered no evidence on this issue, they failed to carry their burden. Therefore, the case may proceed on this claim.

The exception for "obligations imposed by law" applies only to obligations imposed by ***state law*** because a city has no discretion in incurring such a liability. *Rider v. City of San Diego*, 18 Cal. 4th 1035, 1046 (1998) ("[W]e have long held that the debt limitation in section 18 only applies to discretionary debt, not to obligations imposed by state law."). However, neither SDCERS nor any Intervenor contends that the obligations at issue here—the increased pension benefits granted pursuant to MP I and MP II—are obligations imposed by California state law.

Ex. 2205, at 5, clip 4 (198:10-19). Ms. Italiano also testified that the reason she agreed to postpone the contributions was because "that was the way we were going to get the benefits." Ex. 2205, at 5, clip 8 (223:17-23).

More importantly, none has presented any evidence at all on that topic. Rather, the indebtedness allegedly was incurred through discretionary actions by the SDCERS Board in approving MP I and MP II, and it is exactly this kind of discretionary obligation that the Debt Limit Laws govern. *See Compton Comm. Coll. Federation of Teachers v. Compton Comm. Coll. Dist.*, 165 Cal. App. 3d 82 (1985).

In *Compton*, after an exhaustive analysis of the evolution of the exception for "obligations imposed by law," the court concluded that only where state law imposed a "specific duty" on a local government to spend its money on a specified function (as opposed to imposing a general duty to act) would such expenditures "be exempt from the constitutional debt limitations." *Id.* at 91. Under the unique facts of that case, the court noted that state "law imposes a specific duty to provide an education and to employ teachers to do so." Moreover, in *Compton,* the court found that state law "further imposes an independent duty not to ***reduce*** teacher salaries during a contract year." *Id.* at 86. Because the specific duty to pay the teachers' salaries is imposed by state law, and the teachers' salary obligations were not discretionarily incurred by the school district, the obligations were therefore not subject to the Debt Limit Laws. *Id.* at 91-94. In this case, by contrast, state law imposed no obligation upon the City to ***increase*** pension benefits, nor ***retroactively*** to give employees and retirees pension benefits which had ***never been funded*** in the first instance and could only be funded through the device of incurring future debt.

The Court also notes the City has alleged the benefits granted in connection with MP I and MP II were void *ab initio*, and therefore they cannot be "obligations imposed by law." The benefits at issue are not indefinitely binding legal obligations, but are instead implied terms of the employees' contracts of employment: "The pension provisions of a city charter are an indispensable part of the contract of employment between a city and its employees, creating a right to pension benefits . . . ." *Abbott v. City of San Diego*, 165 Cal. App. 2d 511, 517 (1959). Employees' rights under this implied contract are thus limited by general contract principles, including one of the most fundamental: A contract made in violation of the law "may not serve as the foundation of any action . . . ." *Kashani v. Tsann Kuen China Enter.,* 118 Cal. App. 4th

521, 540 (2004). *See also Stockton P. & S. Co. v. Wheeler*, 68 Cal. App. 592, 601 (1924) (where "a statute provides a penalty for an act, a contract founded on such act is void, although the statute does not pronounce it void, nor expressly prohibit it").

This principle applies to contracts created by public entities. "A contract entered into by a local government without legal authority is 'wholly void,' *ultra vires*, and unenforceable." *Midway Orchards v. Cty. of Butte,* 220 Cal. App. 3d 765, 783 (1990). Such contracts are void at inception, and thus cannot serve as a basis for any claim. *S. Bay Senior Housing Corp v. City of Hawthorne,* 56 Cal. App. 4th 1231, 1235 (1997). As the California Supreme Court has explained, a governmental entity may not be bound under the terms of a contract that has been entered into in violation of existing law:

> [T]he contract is void because the statute prescribes the only method in which a valid contract can be made, and the adoption of the prescribed mode is a jurisdictional prerequisite to the exercise of the power to contract at all ***and can be exercised in no other manner so as to incur any liability on the part of the municipality.***

Reams v. Cooley, 171 Cal. 150, 154 (1915) (emphasis added).

Intervenors have offered no evidence to controvert these allegations. Assuming, as the Court does for present purposes, that the pension benefits adopted in MP I and MP II were unlawful, they cannot be "obligations imposed by law."

C. <u>Intervenors Had Notice that MP I and MP II Violated the Debt Limit Laws</u>

Intervenors also had the burden to show that none of them had notice that MP I and MP II violated the Debt Limit Laws. They presented no evidence at all that any Union member or any Union member's agent lacked actual or constructive notice. For that reason alone, as to Phase I, the issue of notice must be resolved in favor of the City.

Nevertheless, and notwithstanding Intervenors' burden (and the fact that several key witnesses on the issue of notice elected to exercise their rights under the Fifth Amendment), the City presented overwhelming evidence that Intervenors did in fact know that the obligations created by MP I and MP II were without current funding and, therefore, violated the Debt Limit Laws. *See* Ex. 155 (July 2, 1996 Resolution No. 287582) (appending the MOUs for each of the

four employee organizations signed by their respective presidents, with each MOU clearly describing the lack of current funding of benefits for MP I).

As to MP II, the Court notes "last, best and final" offers from the City to the four employee organizations. Exs. 272, 274, 282 and 311. Each contained the following language:

> Substantial benefit improvements granted by the City since the adoption of the "City Manager's Retirement Proposal" dated July 23, 1996, (Manager's Proposal) have created additional un-funded liability to SDCERS that was not anticipated when the City agreed to the "trigger" provisions.

Ex. 274.3 (¶ 2). This language is identical in all four exhibits. *See also* Italiano Testimony, *supra*, at 55-56, 59 & n.17, 83 & nn.30-31 (acknowledging that she was fully aware of the deferred funding of the benefits).

Again, *San Francisco Gas Co. v. Brickwedel*, 62 Cal. at 642-43, shows us that "it must be remembered that all are presumed to know the law, and that whoever deals with a municipality is bound to know the extent of its powers." The employee organizations were fully informed that all of these benefits were unfunded, yet they approved them at their peril.

VIII.

THE *CORBETT* SETTLEMENT DOES NOT PROVIDE A BAR TO THE LITIGATION OF THE MP I BENEFITS

In the *Corbett* lawsuit, the plaintiffs, various individual City employees, brought suit against SDCERS and the City as real party in interest, claiming that retirement benefits paid by SDCERS had not been properly calculated in light of the California Supreme Court's 1997 decision in *Ventura County Deputy Sheriffs' Association v. Board of Retirement* because the City omitted certain items of compensation from the calculation. Ex. 930.6 at 3 (*Corbett* Settlement Notice). Specifically, the plaintiffs alleged that they were entitled to have certain payments made by the City over and above their basic salaries and wages included within the base compensation upon which the City's employees' retirement benefits were compensated. *Id.* 930.7. The City's four employee unions also intervened on behalf of each of their respective bargaining units. *Id.*

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The City settled *Corbett* in 2000. As for City employees who terminated employment on or before July 1, 2000, the settlement agreement provides for an increase in their "retirement benefit payment" of a simple 7% both prospectively and retroactively. The retroactive amount was to be paid in a lump sum in October 2000. As for those actively employed by the City on July 1, 2000, the agreement provided for increases in the Retirement Calculation Factor for Safety Members (from 2.5% to 3.0%) and for General Members (from 2.0% to 2.5%), as well as provisions relating to legislative members and DROP participants. MP II raised these factors higher.

The Unions use this settlement to argue that the legality of the benefit increases granted under MP I are irrelevant or moot because the benefit increases under the *Corbett* settlement supersede MP I. In other words, it matters not, they argue, if MP I is set aside as illegal because the City separately is obligated to provide increased benefits under *Corbett*. The *Corbett* settlement is narrower than the issues raised in this lawsuit, however.[32]

Corbett pre-dated MP II and the legality of the additional benefit raises in MP II are not affected by *Corbett*.

As for MP I, *Corbett* granted a simple 7% increase in the retirement benefit payment of those who terminated their employment on or before July 1, 2000.[33] The *Corbett* settlement did

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[32] The *Corbett* settlement itself also does not purport to bind the City indefinitely, or to waive any claims. Rather, it expressly states: "Nothing in this Settlement shall be deemed to grant any party any approval rights over any other actions of THE CITY. ***All parties acknowledge that THE CITY is considering changing portions of the Municipal Code affecting the SDCERS Retirement Plan . . . and nothing in this Settlement shall affect in any way the power of THE CITY to do so*** . . . ." Ex. 930.13-930.14 (emphasis added). Likewise, the Ordinance implementing the settlement states that "nothing in this Ordinance is intended to, nor shall it, change in any way the vested or non-vested nature of any benefit given by the City to its employees." Ordinance No. O-18835 (August 7, 2000) at 1193.18. If the City prevails in this case, the City's obligations under the *Corbett* settlement, as well as the effects of any subsequent MOUs, will be a matter to be considered by the City Council in considering the MP I and MP II benefit increases anew.

[33] Tr. Nov. 8, 2006 a.m. at 77:25-76:7 (Testimony of David Hopkins, the City's and SDCERS's outside counsel in *Corbett*) (explaining that "what *Corbett* settled for was the plaintiffs giving up their claims for those additional pay items to be added on in exchange for an increase in retirement benefits . . . . There was a negotiation that provided increased retirement benefits to both active employees and retired employees, and ***it was that increase that was the consideration for the settlement of Corbett*** . . . .") (emphasis added); *see also*

not entail, nor contemplate, confirmation of the underlying benefits.[34] As one member of the Union negotiating team confirmed, the MP I benefits were already in their pockets when *Corbett* was negotiated. Tr. Oct. 31, 2006 p.m. (Testimony of John Thompson) at 32:24-28 ("Q. By the time that you got to Corbett in 2000, you already had the 1997 benefit in your pocket, correct? A. Yes, sir."). Thus, if a portion of the post-*Corbett* increased benefit payments are illegal under MP I, those payments must be reduced accordingly.

As to those who remained active employees on July 1, 2000, and received an increase in their retirement factor, it is also evident that the *Corbett* settlement did not supersede MP I. This is apparent from the face of the Ordinance later adopting MP II, as well as contemporaneous and subsequent documents. The MP II Ordinance set forth an increase in the General Members retirement factors, which could be calculated in a number of ways: (1) "Old Factor"; (2) "*Corbett* Factor"; or (3) "New Factor." Ex. 74.9 (Ordinance No. O-19121, November 18, 2002) at 9. The "Old Factor" is the June 30, 2000 basis, *i.e.*, the pre-*Corbett* amount. *Id.* at 74.5-74.6, 74.9. Under MP II, adopted in 2002, long after the *Corbett* settlement, employees may elect to have their retirement benefits calculated under the Old Factor, the *Corbett* Factor ***or*** the New Factor. *Id.* at 74.5-74.6. This continuing viability of the pre-*Corbett* Factor is confirmed in the ordinance implementing the *Corbett* settlement. *See* Ex. 1193.11-12, Ordinance No. O-18835 (August 7, 2000) (preserving option to elect use of prior "unmodified" factor). The current MOUs with the Unions maintain this formula, expressly providing that the "Old Factor" remains an alternative for calculating benefits. *See* Memorandum of Understanding Between the City of San Diego and AFSCME, Local 127 (attached as Exhibit A to AFSCME Local 127's Complaint

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id. at 58:8-26 (explaining that the *Corbett* settlement entailed only a percentage increase factor, not any particular value to each individual beneficiary; the "increase remains the same" and "the consideration for the *Corbett* settlement is that increase.").

[34] Tr. Nov. 8, 2006 a.m. at 76:17-25 ("Q. Was the MP I base numbers . . . would they have any part of this settlement in *Corbett*? . . . A. No. They were not part of the consideration for the settlement."); *id.* at 77:25-76:7 ("A. You just asked me questions about whether *Corbett*—whether there was a validation hearing for MP I. Not that I know of. And *Corbett* certainly was not a validation hearing for MP I. Q. And it had nothing to do with MP I? . . . A. No, it had nothing to do with the consideration that was given for the settlement."); *id.* at 77:25-28 (*Corbett* "certainly wasn't a validation hearing for MP-1").

in Intervention filed August 1, 2005) at 7 (¶ A) (General member may elect "to have his or her Allowance calculated using the Old Factors . . . or the Corbett Factors"). Thus, it is evident that *Corbett* did not entirely supersede MP I and the benefits awarded thereunder.[35]

Indeed, Union documents that are contemporaneous with MP II's approval confirm that the legality of the benefits bestowed under MP I and MP II is not mooted by the 2000 *Corbett* settlement. In connection with that approval, the Unions did not assert that MP I had been superseded by *Corbett*; rather, they agreed that MP II was a salutary solution to the problems posed by MP I. Ann Smith, representing MEA, stated: "***Having reviewed the Manager's proposal, MEA has confidence in the integrity of what is being presented.***" Ex. 276.223. "She [assured] the Board that its support for the Manager's proposal is important to 5,000 represented employees. ***MEA has confidence with its analysis that this is an appropriate proposal.***" *Id.* (emphasis added). In other words, if, as the Unions now argue, MP I was wholly superseded by the *Corbett* settlement, MP II would have been unnecessary.

Finally, and most importantly, the *Corbett* settlement does not and cannot alter the basic automatic disclosure and voidness rules of Sections 1090 and 1092. The *Corbett* case did not address the alleged Section 1090 violation, nor did it attempt to invoke the only permissible cure for such a violation as allegedly occurred with MP I: *Corbett* did not follow the procedure detailed above of a disclosure of the violation and conflict, followed by a set aside of the tainted action, replaced with a *de novo* procedure free from the voiding conflict of interest.

In sum, *Corbett* is irrelevant to the justiciability of this lawsuit: That settlement does not preclude resolution of the fundamental question of declaratory relief on legality, or imposition of

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[35] That the 2000 *Corbett* settlement did not supersede MP I is also evident from the other parts of MP II: It is clear that at the time MP II was agreed to in 2002, the participants believed MP I remained in effect notwithstanding the *Corbett* settlement. *See* Ex. 1168 (MP II Agreement dated Nov. 18, 2002) at ¶ 1 ("On June 7, 1996, the City proposed and the SDCERS Board of Administration ('Board') agreed to the City Manager's Retirement Proposal, as modified, ('Manager's Proposal') dated July 23, 1996"); *id.* ¶ 6 ("On July 11, 2002, after due consideration, the Board approved modifications to Section 3 of the Manager's Proposal, contingent on an appropriate written agreement being entered into between the City and the Board"). *See also* Ex. 276.205 (July 11, 2002 Board Minutes) at 4 (system actuary Roeder did not include *Corbett* contingent liabilities in models used to evaluate MP II); *id.* at 24 (employee urging that *Corbett* "alternative" be maintained).

the remedy contemplated by this Court. Rather, if the City prevails, and a remand to the City Council for new proceedings is ordered, the Council will be best equipped to weigh all the competing concerns—including the amount of benefits to be bestowed given the funding requirements mandated by law, and given the City's existing and prior contractual commitments to its employees, in the *Corbett* settlement and elsewhere.

IX.

CONCLUSION AND ORDER

Based upon the foregoing law and matters judicially noticed, after hearing the Phase I trial evidence and weighing that evidence, the Court finds for the City on the Phase I issues discussed above. All necessary parties are before this Court to render a determination on the alleged conflict of interest and the resulting alleged illegality of the benefits provided in exchange for underfunding; the *Corbett* and *Gleason* settlements do not resolve these central issues; and there is a remedy under state conflict of interest law, which authorizes the Court to void the contracts and the implementing official actions, and to remand the matter back to the City Council for new proceedings conducted free from the taint of the prior conflict of interest. The Court can then validate those proceedings, if appropriate, in a subsequent action.

Only by this method can the Court address the conflict of interest and legality issues that have been tendered by all parties before it; respect the legislative and administrative domain to decide specific issues relating to amounts of pension system benefits and funding; and ensure that decision-making is conducted free from the corrupting influence of self interest, thereby restoring taxpayer confidence in the integrity of the benefits and funding decisions.

Finally, the Court holds that the City may proceed to trial on the merits of its Debt Limit Law claim.

IT IS SO ORDERED.

DATED: December ___, 2006

_____
The Honorable Jeffrey B. Barton
Judge, San Diego Superior Court

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SUPERIOR COURT OF CALIFORNIA, COUNTY OF SAN DIEGO

DECLARATION OF SERVICE

Case No. GIC841845
SDCERS v. Michael J. Aguirre, et al., and related Cross-Action Consolidated with Case Nos. GIC851286 and GIC 852100

I, Deena M. Thomas, the undersigned declare that I am, and was at the time of service of the papers herein referred to, over the age of eighteen years and not a party to the action; and I am employed in the County of San Diego, California, in which county the within-mentioned mailing occurred. My business address is 1200 Third Avenue, Suite 1100, San Diego, California, 92101.

On Tuesday, November 28, 2006, I caused to be served the following document described as: **DEFENDANT AND CROSS-COMPLAINANT CITY OF SAN DIEGO'S PROPOSED STATEMENT OF DECISION ON TRIAL PHASE I** in this action by placing the true copies thereof enclosed in a sealed envelope addressed as follows:

Reg A. Vitek Esq./Michael A. Leone, Esq. SELTZER CAPLAN McMAHON VITEK 750 B Street, #2100, San Diego, CA 92101 (619) 685-3003; (619) 685-3100 (fax) vitek@scmv.com ***Attorneys for Plaintiff SDCERS***	Thomas Tosdal, Esq./Ann M. Smith, Esq. TOSDAL SMITH STEINER & WAX 600 B Street, #2100, San Diego, CA 92101 (619) 239-7200; (619) 239-6048 (fax) asmith@tlsslaw.com ***Attorneys for San Diego MEA***
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CCP §§ 1013(A); 2015.5

[X] **(BY MAIL)** I served the individual named by placing the documents in a sealed envelope. I then placed it for collection and mailing with the United States Postal Service this same day, at my address shown above, following ordinary business practices.

[ ] **(BY FAX)** At __, I transmitted the above-described document by facsimile machine to the above-listed fax number. The transmission originated from facsimile phone number (619) 533-5856 and was reported as complete and without error. The facsimile machine properly issued a transmission report, a copy of which is attached hereto. [CCP section 1013(e); CRC Rule 2008].

[ ] **(BY OVERNIGHT DELIVERY)** I caused the envelope(s) to be delivered overnight via an overnight delivery service in lieu of delivery by mail to the addressee(s). [CCP.section 1013]

[ ] **(BY PERSONAL SERVICE)** I served the individual named by personally delivering the copies to the offices of the addressee.
Time of delivery: _____ a.m./p.m. Person served: _____

I declare under penalty of perjury under the laws of the State of California that the foregoing is true and correct. Executed on Tuesday, November 28, 2006, at San Diego, California.

Deena M. Thomas

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